PROFIT

promoting regional opportunities for investment and trade

Considering market forces

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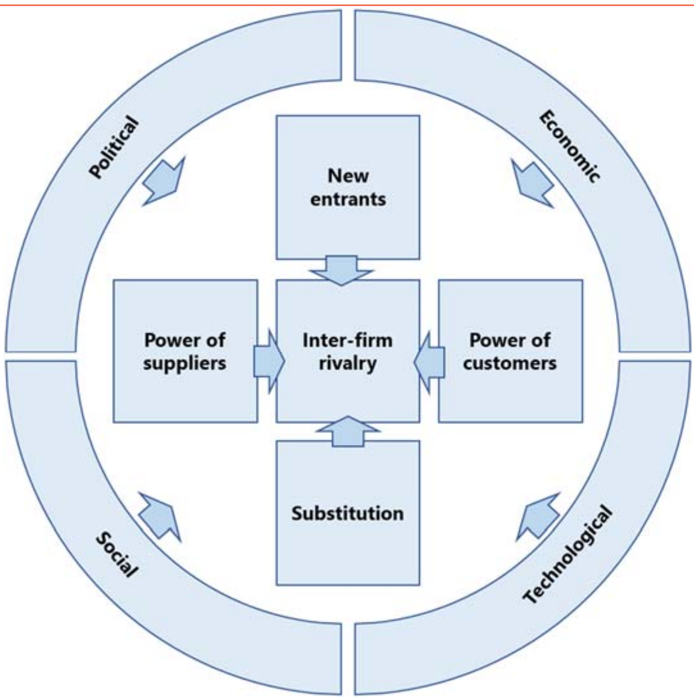
1. Introduction

Your research is intended to assist you to think through whether you can be competitive in a specific market. If you are competitive, you will thrive; if you are not competitive, you will not succeed. There are two models which may be useful both in helping you to direct your research systematically and in analysing what you have learnt from your research.

2. Market environment

The first of these two models, shown in figure 1, portrays the key market forces and influences that can affect market performance and future trends. You may recognise it as a combination of what is often referred to as PEST Analysis (**p**olitical, **e**conomic, **s**ocial and **t**echnological influences), and the concept of the Five Competitive Forces of markets which was developed by Michael Porter of the Harvard Business School.

Figure 1: Market environment model



[1] This factsheet is based on material originally published in Exporting for the First Time by Graham Smith & Paul Sampson and edited by Colin Weatherspoon & David Irwin, copyright Project North East, 1996, and used with permission. It draws on the ideas of Michael Porter of Harvard Business School.

The underlying principle of the model is that markets operate in an environment that can be affected by many driving forces — some that are general to the part of the world you are considering and some that can be regarded as specific to the industry sector.

2.1 External forces

Those which are general — sometimes referred to as *external* forces — can be grouped into the four sections of the outside circle.

Political forces

This refers to current and possible future pressures on the industry brought about by the political situation in the chosen country or region, and any regional, national or international political influences on operations in the marketplace. These may include such aspects as:

- Legislation relating to product specification and packaging.
- Localised health and safety issues.
- Rules about advertising and promotion or government control of media.
- Government attitude towards, and involvement in, economic development and development of free-market economies.
- International trade agreements and the positive or negative affect on import volumes, tariffs, restrictions or barriers.

Economic forces

Economic issues can be closely linked to political issues and can also vary within countries as well as internationally. The factors falling into this group tend to include aspects such as:

- Interest rates and their effect on credit trading and cash flow.
- Inflation and the consequential effect on pricing trends
- General wealth and economic growth trends of the region or country and how this affects such aspects as disposable income and the ability or willingness to buy at given price levels.
- Typical trends in the costs of basic operational requirements such as labour, materials and transport.
- Exchange rate movements and its effect on your pricing/profitability.

Social forces

This group can be one of the most difficult to assess but is also one of the most influential since most of the market drivers that determine what products and services people want to buy, and why, fall into this category. Some factors may directly affect your industry and others may have little relevance and the difficulty is in deciding what is or is not important to you. In conjunction with specific issues relating directly to your market, typical factors you may need to take account of include:

- Demographic trends (age, gender, social status, level of education, etc.).

- Traditional culture and attitudes in your chosen region or country including attitudes to class, gender, race, religion, travel, politics, etc.
- Typical attitudes to the rest of the world and the effect of this on international trading.
- Traditional and developing commercial practices and methods of trading

Technological forces

Technological development trends are not only relevant to directly related industries. For example, trends in education based services can be affected by developments in communication (use of TV, radio, etc.), computing (prevalence and use of educational software, multimedia, etc.), construction (design of educational establishments), psychology (teaching delivery methods), etc. Also the state of technological development can vary from nation to nation. In some cases, this can mean that technology regarded as outmoded here can seem ultra modern in a less technologically developed country. In other situations, it may create a need for further product development where the chosen market turns out to be technologically sophisticated. In this category you need to look at the general technological state of development in the chosen country with specific reference to factors closely linked to your type of product or service.

Some now add 'environmental' issues (e.g. pollution control, recycling, etc.) as a fifth external force but this can be viewed as a combination of political, social and technological forces with economic consequences.

2.2 Competitive forces

Within the circle of external forces, the industry specific, or competitive forces, centre on existing firms competing against each other for business, and the effect on that inter-firm rivalry of, what Michael Porter terms as: the threat of new competitors entering the market; the threat of substitute products or services; the bargaining power of customers; and the bargaining power of suppliers. In your position as an intended exporter to the chosen market, the new entrant issues are not only relevant from a point of view of the possible future threat to your business once established in that market, but also from the viewpoint of your current position as a new entrant trying to break into the market.

Threat of new entrants

This element is concerned with factors affecting the ease with which new firms can enter an existing market. From the point of view of this being a threat to existing players, if the barriers to entry are high there is much less of a threat than if it is fairly easy for a new firm to join in the market. Conversely, as a new entrant you will be happier if there are few issues that pose a major block to entering the market. Examples of the factors which can be barriers or advantages, dependent of the degree of difficulty involved, include:

- Ability to gain access to distribution channels or sources of necessary materials.
- Steep or lengthy learning curve

- Ability to achieve necessary economics of scale or achieve significant cost advantages.
- Cost of essential capital requirements
- Reluctance of customers to change suppliers due to entrenched brand loyalty or high cost of switching
- Possibility of deliberate action to deter entrants through government policy or aggressive retaliation from existing players.

Supplier power

An assessment of this aspect is concerned with identifying if any of your suppliers could be in a position to cause potential difficulties because they hold bargaining power for one reason or another. That is not to suggest that you think they will but determining whether there is any risk that they could, should supplier relations breakdown for whatever reason. The classic extreme example of this is the international supply market for rhodium where South Africa is the sole global supplier. Typical factors to look out for include:

- A monopoly of supply or concentration of supply among few firms versus having a abundant choice.
- Existence of substitute components which can be used versus being restricted to specific types of materials and/or particular sources due to cost/quality differences.
- Inherent cost of switching sources of supply — both to your business and to existing suppliers — and the importance of volume to the supplier.
- Relative cost of components from a given supplier compared with total purchase costs and the potential effect of switching suppliers on your products and pricing.
- The degree of risk that suppliers would be able to, and wish to, incorporate your type of business into their own operation and thereby become competitors, or be able to bypass your position in the supply chain and sell direct to your customers.

Threat of substitution

In many markets, customers have the choice not only of buying your particular type of products or services — from you or your competitors — but also of choosing some other method to solve the problem. For example, software developers selling accounting packages are not only competing against each other, they also face customers deciding to use manual systems as the substitution option. Similarly, firms offering consultancy services face the substitute threat of customers opting to address the problem internally as well as having to compete against other consultancies. Typical factors to note include:

- Customer perceptions of price and/or quality differences between your type of product or service and any substitutes they could choose.
- The degree to which customers have easy access to information about, or are already aware of, substitute options.
- Existing tendency (habit) and potential future trend for buyers to opt for substitutes.
- The cost to the buyers of switching from their current supplier to your proposed product or service.

Power of customers

Customers are obviously important because, of course, without customers there is no market. They usually have notable buying power simply because they are in a position to choose who they buy from although this is not necessarily always the case. You may be fortunate in being the sole supplier of a particular type of product or service aimed at a particular target group — often called niche marketing — but even so, such luxuries seldom last for long. In some markets, particular circumstances can make it very difficult for some or all customers to exercise much bargaining power — typically situations where demand outstrips supply. In many other markets customers can often have enhanced bargaining power for a variety of reasons. Points to consider in this element of the model include:

- Whether there is a large number of customers or just a few and the number of firms chasing the business.
- To what extent a handful of influential buyers account for the majority of purchases coupled with the need for sellers to achieve volume sales.
- The amount it would cost customers to switch from one supplier to another, coupled with the degree to which they are already aware of, or are able to get hold of sufficient information on, alternative sources of supply.
- Whether customers would find it easy and/or more attractive to develop their own internal source of supply.
- Existence of viable and easy to find substitute products or services.
- How much your market is affected by activity in the customer's marketplace in situations where the customer has significant control over their market.
- The degree to which market volume is sensitive to variations in price.
- To what extent brand loyalty and/or product differences and/or buyer incentives have an affect on purchase decisions.

Rivalry determinants

Much of the above will have a direct effect on the degree of competition between rival firms operating in the market. However, in addition to the pressures from the other elements of the model, there are some issues that emanate specifically from this element including:

- The extent to which market growth can support the number of competing firms
- Seasonality affecting storage costs, capacity requirements and any resulting need for volume to be profitable.
- Existence of clear product/service differences and/or brand identity leading and resulting in strength of supplier or brand loyalty from customers.
- Relative level of customer relation costs and costs of developing new customers affecting the approach to business development.
- The position regarding concentration and/or diversity of competitors affecting the degree to which they directly compete.
- Influence of corporate stakeholders in the marketplace
- The degree to which exit barriers discourage competitors from leaving the market.

2.3 Assessing market environment

Few, if any, firms have the luxury of being able to directly manage their market environment since many of the market forces are out of their control. Yet, in the main, it is these factors which cause new opportunities to arise, pose potential threats to players in the market, and affect the potential profitability of markets.

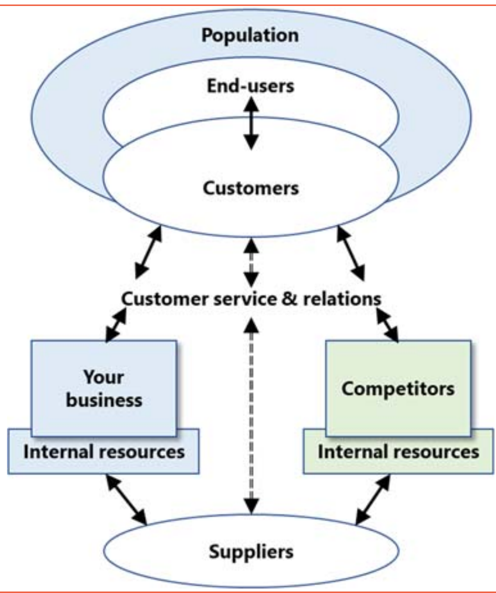
Therefore, in assessing market environment, the objective is to identify what factors have played an important part in market development to date, what is having a major effect on current market activity, and what is most likely to influence future market development. The market environment model provides a basic framework for assessing the external and competitive market forces.

Working through your research information you can deduce key features and notable implications from your findings by thinking through the main points relative to each of the market forces as noted above. You can then develop a summary of your conclusions and use this to identify the key trends and thereby plan to make the most of your opportunities and avoid any significant threats to your future success.

3. Market structure and activity

Figure 2 portrays a basic marketplace structure and serves as a useful framework for considering the other research issues — market size, customer attitudes and requirements, competitor activity and the supply chain — referred to earlier.

Figure 2: Market structure



3.1 Customers and end-users

The top portion of the diagram reminds us that customers represent only a proportion of the selected population and may not be the actual end-users, or ultimate beneficiaries of the product or service. Using your research data to determine how you can identify who are, or are not, customers and/or end-users will help make your targeting, and subsequent selling and promotional activity more efficient and effective.

The profile you produce can also provide you with a basis for deducing an estimated size for your potential market. For example, if you are able to show that there are, say, 10,000 people who fit the profile and you conducted a survey that indicated 15 of the 50 respondents (or 30%) would be keen to try your product or service, then this suggests you might expect around 3,000 of the total target group to be interested. If you also know the likely total spend per year then you can use the calculation *people x $spend* to estimate the potential annual value of the business.

The main relationship highlighted in the model is the one between your business and the customer. This reminds us that markets are all about identifying and satisfying customer wants and needs. This is easier to say than do, but your research will have given you many clues to customer requirements and attitudes. Frequently, intending exporters find that customer requirements are not quite as expected but it is important that you have a reasonable idea of what will be expected at this stage. This is because you will need to take account of any resource implications which arise from your findings. For example, if it is fairly clear from your research that most customers will want a 24-hour support service, you will need to have worked out how you could provide such a service and have it in place at the time of, or before, taking the first order.

Clues to what customers may require come not only from the results of direct questioning on their expectations, but also from their comments about existing suppliers — what they like or don't like about existing services. Whilst it can be difficult to precisely quantify subjective responses from customer requirements and attitude surveys, you should be able to spot any points that seem to arise frequently and get a good feel for what they are basically looking for.

Remember that, as the model reminds us, it is unlikely to be just you trying to satisfy customer needs. As a new entrant to the market, simply meeting the basic requirements is often not enough to persuade customers to switch. You need to be sure you know as much as possible about potential competitors and what customers think about their products and services. You will be looking for features that make your product or service more attractive to the customer in that they offer some desirable benefit not generally available from the existing suppliers. Of course, if some negative point about existing services crops up quite a few times in the responses from prospective customer surveys, you have a pointer to something that you may be able to use to differentiate your product or service from that which is currently available in the export market.

3.2 Supply chain position

Looking at the vertical 'flow' through the market structure model you will see that it represents a very basic picture of supply chain — from your suppliers, through to your business or competitors' businesses, to the customers and on to the end-users. The results of a more detailed assessment of the supply chain in any given market can vary considerably.

The diagram in Figure 3 expands on the simple supply chain where those involved in each stage essentially just sell down the chain until the point where the final product/service package reaches the customers/end-users. Figure 4 shows an example of how, in many markets, the supply chain can turn out to be much more complicated. In this case it appears everybody is trying to sell to almost everybody else (it is actually modelled on a building services market). Of course, not everybody is selling exactly the same product/service package. For instance, the service end of the chain may be buying finished products and focusing their business on, say, supply and install, whereas the manufacturers may be dealing in parts and/or finished products with little, if any, service arrangements.

Figure 3: simple supply chain

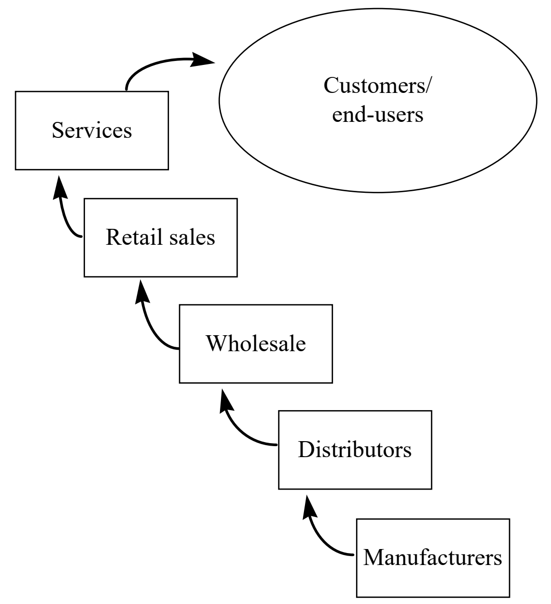
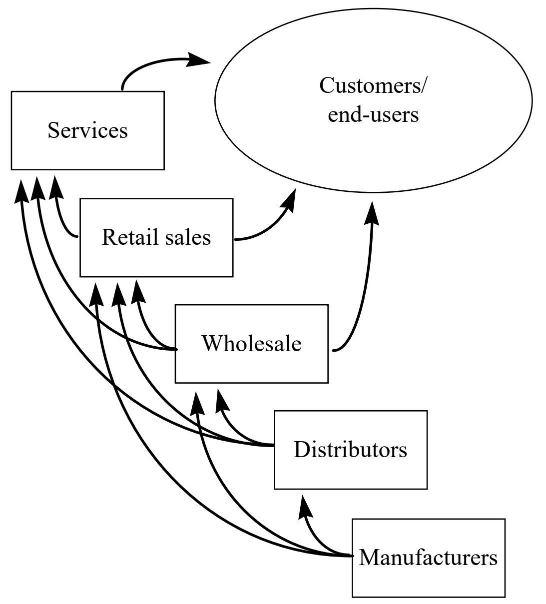


Figure 4: complex supply chain



Assessing the data from your research will enable you to build up an appropriate picture of the supply chain situation in your chosen export market and determine what each group is attempting to sell to its target customer group(s). Armed with this information, and a clear understanding of your own strengths and weaknesses, you will be in a much better situation to start to firm up on where in the supply chain you want to position your business in the export market and thus develop a more precise definition of who you expect your customers to be.

3.3 Strengths and weaknesses

If you are already familiar with the concept of a SWOT analysis (strengths, weaknesses, opportunities and threats) it will come as no surprise to find that, as the summary of your market environment research was focused on opportunities and threats, the summary of your research into market structure and activity is focused on strengths and weaknesses. This is principally because success in any market is being able to do a better job of satisfying the target customer group and an assessment of strengths and weaknesses is mainly concerned with identifying what you are good at and what you are not so good at.

When assessing your strengths and weaknesses, it is worth noting that there are two points of view you need to consider. Firstly, from your competitor research you will be able to develop your own view of how well you compare with the competition. When looking at it from this point of view your assessment will include aspects such as production efficiency, technological capabilities, financial strength, distribution capabilities, etc. These are internal factors related to how well your business performs relative to your competitors. The second viewpoint is that of the customers. They are unlikely to be particularly concerned about whether your production process is more efficient than a competitors, or whether you have more up-to-date equipment. They are much more likely to base their view of your strengths and weaknesses on factors such as speed of response, standards of customer care, product quality issues and perceived value for money — the issues that matter to them.

Assessing your strengths and weaknesses from both points of view helps by encouraging you to think in terms of what your customers really want and, consequently, what resources you will need to be able to do that better job of satisfying those requirements.

4. Conclusion

Using these two models to assist with your analysis will ensure that you take a systematic approach and, further, ensure that you do not omit vital information – which should help you in coming to decisions about whether to trade or invest internationally and, if so, which approach might be most advantageous.

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