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The Determinants of the Attractiveness of an Industry: An Extension of The Porter's Five-Forces Framework

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Abstract

In this paper, I review and provide a more extensive theoretical grounding for Porter's five-forces model for the determination of the attractiveness of an industry. I argue that the model is incomplete given its implicit assumptions about a firm's financing activities in implementing its competitive strategy. It is my opinion that an absolute paradigm for the determination of the attractiveness of an industry must take into consideration the industry's optimal capital structure as well as the tendency for the power of providers of debt capital to vary across industries and to be crucial in the formation of industry profitability.

Index terms— industry attractiveness, competitive forces, optimal industry capital structure, power of lenders.

1 I. Introduction

he extent of profitability of an industry varies from one industry to another industry and the profitability of a specific industry can be accounted for on the premise of the strength of competitive forces that are prevalent in that industry (Porter, 1980). Porter (1980) developed a model that strived to identify and explain the economic structures that shape the overall impending profit potential of a given industry. Specifically, Porter (1980) established the five forces framework that sought to account for the factors that underpinned the ability of a firm to create and capture profits within an industry. According to Porter (1980), the attractiveness of an industry (A) is a function of the bargaining power of buyers (B), the bargaining power of suppliers (SS), the threat of new entrants (E), the intensity of industry rivalry (R), and the threat of substitutes (S). The functional form representation of this theory can be expressed as follows. Industry Attractiveness, $A = f(B, SS, E, R, S)$

Ensuing work implemented by several other researchers has corroborated or provided supplementary evidence that substantially lends credence to the model of industry attractiveness as proposed by Porter (1980). Notwithstanding the significance and appeal of the paradigm projected by Porter (1980), I would argue that it is not comprehensive. I maintain that there is at least one other variable that impacts on the fortunes of industries to a varying degree and thus possesses the capability to bear a tremendous threat on the long-run potential profitability of an industry. More explicitly, Porter's model does not incorporate the fact that in non-perfect capital markets the value of a firm is dependent on its capital structure (Modigliani and Miller, 1958) and by implication the maximum value or attractiveness of an industry is also dependent on the optimal average capital structure of the industry. Modigliani and Miller (1958) posited that given perfect capital market conditions, the market value of any economic organization does not depend on its capital structure and is derived by discounting its expected cash flows at the discount rate suitable for the firm's risk. The market value of an industry is analogous to and/or is one tool that can be applied in evaluating the attractiveness of an industry (Ceccagnoli, 2009). Porter's model invariably provided grounds for explaining how the value of the expected cash flows of the firm emanates but clearly did not account for the role of capital structure in assessing the attractiveness of an industry under natural capital market conditions. Furthermore, Porter's model did not consider the role of the power of lenders, who the firm may elect to leverage upon to implement its strategy and maximize the value of the organization, in the determination of the attractiveness of the industry.

In a bid to plug this orifice, this essay attempts to integrate corporate finance theory in accounting for the determinants of the attractiveness of an industry in consistency with the propositions of Myers (1974) for

46 simultaneity in making company financing decisions and corporate investment choices given the high level of T
47 The Determinants of the Attractiveness of an Industry: An Extension of The Porter's Five-Forces Framework
48 interdependence between them. This article also strives to explain why the concepts of the optimal capital
49 structure of an industry and the power of lenders are indispensable elements of any completely specified paradigm
50 of the attractiveness of an industry.

51 2 II. Key Assumptions and Definitions

52 Prior to advancing further, it is essential to; explain vital concepts; describe the bounds of this essay; deliberate
53 upon the circumstantial foundation of the protracted theoretical paradigm of the attractiveness of an industry
54 proposed; and scrutinize the significant assumptions that led Porter (1980) to exclude the optimal average
55 industry capital structure and the power of lenders from his model.

56 3 a) Definitions and Scope

57 For the purpose of clarity and precision, I will provide a working definition of important concepts applied in
58 this essay and delineate the scope of the model of interest. Andrews (1949) defined an industry as any cohort
59 of individual businesses which are characterized by operational processes and systems that are tremendously
60 comparable and having adequately analogous foundations of knowledge and experience such that each of them
61 could produce the specific product that is the focus of consideration, and would undertake that if it is adequately
62 profitable. Hofstrand (2009) posited that profitability is the principal objective of the entirety of business
63 organizations. In the absence of profitability, the business will lack the capacity to subsist in the long run,
64 all other factors held constant. He further highlighted that profitability could be measured with a statement of
65 income and expenses. While revenue is money engendered by the firm's economic activities, expenses constitute
66 the cost of resources expended in the course of undertaking the economic activities of the firm.

67 The attractiveness or potential profitability of an industry is not cast in stone and can change over a period
68 of time, given that firms can influence the strength of the five competitive forces through competitive strategy
69 (Porter, 1980). We can predict the profit potential or the attractiveness of an industry by utilizing the five-forces
70 framework (Porter, 1980). In this essay I propose that the power of lenders and the optimal capital structure of
71 the industry be incorporated into the framework for the assessment of the attractiveness of an industry. Finally,
72 in this paper, the optimal capital structure is delineated to imply or infer the optimal usage of debt in the
73 structure of the firm's capital (Bowen, Daley & Huber, 1982).

74 4 b) Applicable Theories of Corporate Finance

75 Given perfect capital market conditions, Modigliani and Miller (1958) proposed that the market value of any
76 business organization is not dependent on its capital structure and is derived by discounting its expected cash
77 flows at the discount rate suitable for the firm's risk. Therefore, the theory proposed by Modigliani and Miller
78 (1958) helps us to understand that in the absence of perfect capital market conditions, capital structure is
79 an important determinant of a firm's market value because of the tax benefits of debt, financial distress costs
80 associated with debt and agency costs of asymmetric information. Berk and DeMarzo (2006) enumerated several
81 costs and benefits of incorporating debt in the capital structure. Tax benefits of debt result from the reduction
82 in the taxable income of the firm arising from the tax deductibility of interest expenses on the debt of the firm.
83 Thus, interest tax shield contributes to an increase in the value of a firm. Debt can assist the equity holders or
84 investors of the firm in extenuating agency costs connected to the uncoupling of ownership from the management
85 of the firm. Capital structure is also crucial for the reason that agency costs can emanate from asymmetric
86 information. There is an occurrence of asymmetric information whenever the management of the firm is in
87 possession of information about the firm's risk, potential profitability, and prospects that are inaccessible to the
88 investors or other imperative stakeholders of the firm. In this situation debt capital, or commonly the nature
89 of the firm's capital structure can be applied to signal the projections and prospects of the firm to members of
90 the investment community and other crucial stakeholders of the firm. This can be monumental in ensuring that
91 investors allocate the firm a befitting valuation in the course of any round of capital raising. Furthermore, debt
92 can support the shareholders in precluding the managers of the firm from embarking on unwarranted consumption
93 of perquisites or executing projects that do not engender positive cash flows for the firm. Although the usage of
94 debt can be advantageous to a firm by enhancing the value of the levered firm, on the flip side, the existence of
95 debt in the capital structure can generate substantial explicit and implicit costs in the event of crystallization of
96 financial distress upon the firm. We understand that a firm can be in financial distress regardless of its capital
97 structure. However, the exploitation of leverage can significantly raise the risk of bankruptcy since the firm is
98 obligated to make payments of interests and repayments of capital borrowed, notwithstanding its liquidity and
99 profitability. If the firm is wholly financed with equity capital, it is more likely to encounter a lower risk of
100 financial distress because it is not obligated to make payments to shareholders.

101 Jensen & Meckling (1976) provided an exhaustive explanation of the agency costs associated with financing
102 provided by outsiders. Jensen & Meckling (1976) identified that rational investors anticipate that their stake in
103 the organization will alter the manager's incentives. Therefore, they discount the value they are prepared to pay
104 for the shares of the firm. They further stipulated that agency costs can also arise when outside investors invest

105 in the debt of a firm managed by insider owners. Debt financing engenders a motivation for asset substitution
106 for the reason that debt enables equity to become a call option on the firm. Debt financing has other agency
107 costs, including costs of monitoring and enforcing contractual covenant provisions as well as costs of bankruptcy
108 and reorganization. However, Jensen (1986) pointed out that debt may also have an advantageous effect on
109 agency costs in the manager -shareholders relationship since debt commits the firm to pay out free cash flows and
110 therefore introduces a constraint on the volume of funds accessible to the manager for spending on perquisites.

111 Finally, I summarize the works of Bowen, Daley & Huber (1982). Bowen, Daley & Huber (1982) deduced
112 four main inferences from their research study. Firstly, there is a statistically significant variance between
113 average industry capital structures. Secondly, that the rankings of average financial structures of industries were
114 characterized by a statistically substantial steadiness over the complete period of time examined. Thirdly, that
115 companies demonstrate a statistically substantial propensity to navigate towards their industry average over
116 both five-year and ten-year periods of time. Finally, they furnished evidence consistent with the DeAngelo-
117 Masulis postulation that the level of tax shields (made available by depreciation, tax credit emanating from the
118 firm's investment activities, and tax loss carry forward generated from the firm's operating activities) contributes
119 substantially in shaping the optimal utilization of debt in the financial structure of unregulated firms at the
120 industry level.

121 **5 c) Implicit Assumptions of the Porter's Five-Forces Frame-** 122 **work**

123 Porter's five-forces framework recognizes the power of suppliers in the determination of the likely profitability
124 of an industry. I would believe the intention of Porter (1980) in incorporating suppliers into his model was not
125 to associate or integrate suppliers of capital in his denotation of the concept of suppliers because there was no
126 detailed description of the potential role of debt capital providers in the determination of the fate of an industry in
127 his model. However, the ability of a firm to raise debt capital can significantly alter its profitability circumstances
128 and the value of the firm (Modigliani and Miller, 1958). More so the nature and size of providers of debt capital
129 can vary from industry to industry. For instance, in the banking industry, I would argue that the plethora of
130 savings account holders can be viewed as providing debt capital but characterized by minimal bargaining power.
131 However, in other industries, absent trade credit, debt capital is predominantly sourced from financial institutions.
132 Thus, the power of providers of debt capital is fundamental in shaping the attractiveness of an industry and the
133 magnitude of that power can vary across industries (Broberg, Tagesson & Collin, 2010; Sengupta, 1998). In the
134 worst-case scenario, lenders can wholly shut down the competitive activities of a firm in the event of bankruptcy
135 and take over the entire assets of the firm to the extent that it can support the recovery of their debt investments
136 (Berk and DeMarzo, 2006). We can therefore understand that the power of lenders is a force that cannot be
137 overlooked in the assessment of the potential profitability of an industry. This tendency of lenders or providers
138 of liability to facilitate or debilitate the outcome of an industry in terms of profitability was not accounted for in
139 Porter's five-forces framework. Thus, by not accounting for the role of capital structure and or liabilities (debt)
140 in the determination of the future fortunes of an industry, Porter's framework makes two implicit assumptions,
141 including the following.

142 Taking into consideration the applicable theories of corporate finance, any theory that accounts for the
143 determinants of the future potential profitability of an industry should incorporate a reflection of the optimal
144 capital structure of the industry (OC) and the power of lenders (PL) within that industry as demonstrated in the
145 functional relationship shown below. Industry Attractiveness, $A = f (B, SS, E, R, S, OC, PL)$ III. Extending
146 the Porter's Model of Industry Attractiveness (the Initial Steps)

147 a) The Power of Buyers Porter (1980) undertook a thorough evaluation of the power of buyers. He posited
148 that buyers embody a competitive force given that they can exert a downward pressure on prices, make an order
149 for superior quality or additional services, and influence rivalry among competitors. Numerous other scholars
150 corroborate the proclamations of Porter (1980). Kelly & Gosman (2000) observed that buyer concentration
151 reduces profitability primarily in competitive industries as against in oligopolistic industries. Cowley (1986)
152 observed that the profitability of a sample of business units was unfavorably connected to buyer concentration.
153 Cool & Henderson (1998)

154 **6 demonstrated that buyer power elucidates a considerably** 155 **larger fraction of the variance in the profitability of sellers** 156 **than**

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158 1. The optimal capital structure of the industry has, at best, peripheral explicit effect both on the performance
159 of a firm as well as the success of its strategy and on the attractiveness of an industry. 2. The firms in an
160 industry always possess sufficient financial resources to implement their chosen strategy or can always finance
161 the implementation of their strategy or the execution of their projects through the issuance of equity.

162 does supplier power. Contrary to Kelly & Gosman (2000), Schumacher (1991) recognized that exceedingly
163 concentrated buyers display substantial power to weaken profitability particularly in oligopolistic industries

164 specializing in consumer goods. Gabel (1983) demonstrated that the growth in seller profitability is directly
165 proportional to the extent to which buyers are disseminated across numerous industries, nevertheless that no
166 other buyer attribute applies a substantial effect on either the concentration or the profitability of the selling
167 industry.

168 According to Porter (1980), a buyer group will be influential if it buys substantial volumes in relation to the
169 total revenue of the seller, so it becomes financially crucial to the seller to retain the big buyer's business. This
170 position was corroborated by Snyder (1996), who demonstrated that big buyers obtain lesser prices from sellers,
171 given that suppliers compete more aggressively for the business of larger buyers, creating an opportunity for big
172 buyers to pay lesser than their smaller rivals. Buyers can seek to enhance their power. Porter (1980) highlighted
173 that if buyers are either previously partly integrated or can credibly signal a robust threat of backward integration,
174 then their bargaining power is strengthened. Inderst & Shaffer (2007) demonstrated that, in the aftermath of
175 a merger, a retailer might be motivated to boost its buyer power by pledging to a 'single-sourcing' procuring
176 strategy. The absence of influential buyer groups or price discrimination may lead to diminishing competition in
177 the buyers' industry. Grennan (2013) found that a greater degree of uniform pricing is unfavorable to hospitals
178 resulting in softer competition.

179 Buyers can sometimes seek to match the degree of concentration within the ranks of suppliers. However, on
180 some other occasions, they implement strategic actions to boost their productivity. Lustgarten (1975) postulated
181 that buyer concentration was definitely associated with seller concentration and undesirably associated with the
182 cost margin of seller prices. Snyder (1996) demonstrated that buyers' mergers increase profit for all buyers, not
183 just the merging pair, at the expense of the sellers. On the contrary, he further specified that the organic growth
184 of buyers are detrimental to buyers that do not experience growth and is advantageous to sellers. Chambolle
185 & Villas-Boas (2015) asserts that competing retailers may elect to differentiate their suppliers or supplying
186 manufacturers, even at the cost of reducing the value of the goods proffered to consumers, in a bid to enhance
187 their buyer power. Chipty & Snyder (1999) showed that cable operators integrated horizontally in order to
188 achieve productivity gains rather than to improve their bargaining position against suppliers of programs.

189 Finally, the bargaining power of purchasers can also be a function of the importance of the supplier's
190 product in the buyer's operations or business and the switching costs that must be incurred in a bid to change
191 suppliers (Porter, 1980). Bedre-Defolie & Biglaiser (2017) postulated that in markets characterized by longterm
192 contracts, early-termination or breakup fees, a form of switching cost, are gainfully exploited to preclude entry,
193 notwithstanding the new entrant's productivity advantage or switching costs levels, with accompanying effects
194 of a reduction in the welfare of consumers.

195 7 b) The Power of Suppliers

196 Several studies corroborate these postulations. Cool & Henderson (1998) found the occurrence of various power
197 concepts in the samples they studied. Additionally, they demonstrated that the effects of industry characteristics
198 are more significant than the effects of organizational factors in accounting for the profitability of a seller and
199 recommended that supplier power explains a substantial proportion of variation in seller profitability. Neumann,
200 Böbel & Haid (1979) observed that market structure and risks existing within the ranks of suppliers account
201 for a major fraction of the profitability of joint stock firms of German origin. Cowley (1986) observed that the
202 profitability of a sample of firms studied are favorably related to the concentration of sellers. Porter (1980)
203 paid close attention to the power of employees and identified labor as a specific form of supplier. He posited
204 that labor exerts great influence in numerous industries, and that the potential for labor to exert tremendous
205 influence is dependent on the scarcity and skill of labor, the capacity for expansion of the scarce varieties of
206 labor, the unionization of labor and the extent of organization of labor. Other factors can consolidate or enervate
207 the power of employees in influencing the attractiveness of industries. Employee wages, organizational culture,
208 and employees' organizational commitment can be a source of value creation and can vary across industries.
209 Dickens & Katz (1986) Porter (1980) highlighted that suppliers could wield competitive power in an industry
210 by elevating prices or diminishing the standard of quality of the goods they sell, squeezing the profitability of
211 adjacent industries in the supply chain. Porter (1980) further argued that the factors that deepen supplier's
212 power include; the domination of the supplier group by a limited number of firms and the supplier industry
213 possessing a greater degree of industry concentration than the industry it sells to; suppliers wielding a reliable
214 threat of frontward integration; suppliers not having one specific industry representing a substantial part of sales;
215 the ability of the supplier to differentiate its products and establish switching costs. Legault (2009) observed that
216 the creativity and innovativeness of highly skilled workers in Canadian business-to-business (B2B) technology
217 services firms was a form of organizational commitment and a source of competitive advantage for these firms
218 over firms in other industries.

219 Christensen & Gordon (1999) demonstrated that the connection between culture and performance is contingent
220 upon the type of industry. Bernhardt, Spiller & Theodore (2013) investigated minimum wage, overtime, and other
221 workplace infringements in the labor market for low-wage employees. They observed the existence of significant
222 disparity in both the combination and the pervasiveness of violations across industries. ??eil (2007) noted
223 that though government agencies would wish to see a reduction in the prevalence of infringements of workplace
224 policies, constraints in available resources for investigation and the frequently-politicized environment surrounding
225 regulatory decisions have resulted in agencies of government relying on worker complaints for enforcement of

226 workplace policies. Additionally, Weil (2007) observed; that there exists a high degree of variation in complaint
227 rate across industries and that fundamental compliance circumstances explicate a comparatively trivial percentage
228 of total complaint activity. I would argue that such variations in compliance with workplace policies across
229 industries can contribute to disparities in inter-industry value creation.

230 Additional factors that can facilitate or enervate the power of employees in influencing the attractiveness of
231 industries include employee stability and labor productivity. Organizational performance is positively related to
232 employee stability (Kurdi & Alshurideh, 2020), and labor productivity (Edwards, 1958). Employee stability, in
233 turn, varies by industry characteristics. Feinberg (1979) observed that even after controlling for worker differences,
234 more concentrated industries provide less stability in employment (excluding women and workers with the most
235 outstanding educational attainments). Weiss (1966) noted that this would probably not be problematic if workers
236 are compensated for the added employment risk; however, Weiss (1966) found, after accounting for personal
237 characteristics, that more concentrated industries did not pay higher wages. Edwards (1958) demonstrated that
238 labor productivity varies considerably from industry to industry and from industry group to industry group.

239 Researchers have observed the possibility for a consolidation or a weakening in the power of suppliers. Suppliers'
240 power can be debilitated by the embeddedness and brand recognition of firms in the successive stage in the
241 supply chain. Kim (2017) demonstrates that customer concentration and interconnection unfavorably impact
242 the supplier's ensuing year returns on assets. In contrast mutual dependence augments them and decreases
243 the unfavorable effect of customer concentration on the profitability of suppliers. Amato & Amato (2009)
244 observed that the profitability of small manufacturing firms is unfavorably impacted by substantial market share
245 of shopping-goods retailers. On the contrary, in markets for convenience goods, the big market share of retailers
246 has no impact on manufacturers' return. They posited that strong private brands might offer bargaining power for
247 convenience goods retailers when they negotiate with brand manufacturing firms that have a national presence.
248 Suppliers' power can as well be strengthened by bundling practices. Chambolle & Molina (2019) demonstrated
249 that buyers' bargaining power elucidates the advent of bundling practices by a multi-good producer in foreclosing
250 more resourceful upstream rivals.

251 8 c) The Threat of Entry

252 The entry of new firms into an industry frequently brings about a reduction in the profitability of the industry.
253 Porter (1980) posited that new entrants to an industry introduce new capacity, the yearning to capture market
254 share, and frequently tremendous resources. They can exert downward pressure on prices or worsen cost positions,
255 reducing industry profitability. However, there are other consequences of entry that can improve the fortunes
256 of incumbent firms. McCann & Vroom(2010)examined the prospect that entry could also furnish opportunities
257 for existing firms. On the basis of the theory of agglomeration, which delineates the advantages that could
258 emanate from collocation of competitors, McCann & Vroom (2010) explicitly investigated the agglomeration and
259 competitive impact of entry by applying unique data about Texas hotels and found that existing firms could
260 set higher prices when confronting entrants whose agglomeration advantages are expected to overshadow their
261 competitive consequences. Geroski (1989) posited that under some conditions and to a certain degree, entry and
262 innovation can stimulate the economic productivity of incumbent firms.

263 For entry to be made, potential new entrants have an expectation about attainable profits in the industry.
264 Porter (1980) asserted that entry decisions frequently hover around the entry deterring price, which is defined
265 as the price, which after adjusting for the good's quality and service, is just sufficient to cover the expected
266 rewards from entry against the anticipated costs. Porter (1980) additionally posited that entry costs into an
267 industry would be dependent on the probable reaction from existing competitors and significantly on barriers to
268 entry into the industry. The entry deterring price can be a limit price in which the incumbent firm charges a
269 price between the monopoly price and the long-run average cost (Bain, 1949). However, under certain conditions,
270 the limit price can lie above the monopoly price. Harrington (1986) demonstrated that, in a monopoly market,
271 if the potential new entrant is not certain about its cost function and if unit-level costs of the entrant and the
272 incumbent firm have adequate positive correlation, the limit price will be higher than the monopoly price and
273 entry can be deterred by the incumbent by setting a price that is equal to or greater than the limit price.

274 New players, in a bid to participate in production in an industry, must challenge certain barriers to entry.
275 Porter (2008) posited that the entry barriers that would probably be confronted by a new entrant include "supply-
276 side economies of scale", "demand-side benefits of scale", "customer switching costs", "capital requirements",
277 "incumbency advantages independent of scale", "unequal access to distribution channels", and "restrictive
278 government policy"(pp:26-28). Other researchers have demonstrated the existence and significance of entry barriers
279 in various ways. Pehrsson (2009) observed that new entrants to an industry acknowledge the existence of entry
280 barriers and respond both by selecting a broader product/market scope and by differentiating its products to a
281 greater degree than executed by initial entrants. Ceccagnoli (2009) demonstrated that sturdier appropriability at
282 the level of the firm, accomplished via patent protection or the proprietorship of dedicated complementary
283 resources, results in greater financial performance, as evaluated by the market valuation of the equity of
284 an organization's R& D assets. Rosenbaum & Lamort (1992) demonstrated that entry barriers of product
285 differentiation diminish rates of entry, and costs associated with sunk capital lower rates of exit. Dreher &
286 Gassebner (2013) indicates that the occurrence of proliferation of procedures mandatory for starting a business,
287 and a more immense minimum amount of capital required to bring a business to reality are damaging to the

288 evolution of entrepreneurship or new entrants in an industry. Robinson & Phillips McDougall (2001) observed
289 the mediating impacts of the stage of the industry life cycle and entrepreneurial strategy on the discrepancy in
290 firm profitability and organizational growth. Burke & To (2001) demonstrated that investment in endogenous
291 barriers to entry and wage ceilings on executive salaries might enhance market performance.

292 There are other sources of entry barriers, as demonstrated in a plethora of research works, though they
293 are closely related to the entry barriers identified by Porter (1980). Schmalensee (2004) postulated that an
294 increment in the significance of sunk cost is associated with a reduction in the attractiveness of entry, making
295 it plausible in some policy settings to infer that sunk cost generates a barrier to entry. Eaton & Lipsey (1980)
296 demonstrated that the durability of capital is a source of entry barriers. Mueller & Tilton (1969) demonstrated
297 that research and development costs are a specific form of entry barrier arising primarily from the existence and
298 degree of economies of scale in research and development activities and secondarily in the buildup of patents and
299 knowledge by the incumbent firm. Eswaran (1994) demonstrated that an existing firm in a market susceptible
300 to the threat of entry could capitalize on its first-mover advantage by incentivizing firms not including probable
301 entrants but those that would otherwise not enter the industry to purchase a license to its technology in order
302 to deter entry, effectively instituting licensing as a form of entry barrier to certain potential entrants. Porter
303 (2008) asserts that the threat of entry is dependent on the height of barriers to entry and the expected reaction
304 of the incumbents to entry. Porter (1980) went further to assert that high entry barriers and the accompanying
305 low threat of entry generate an auspicious environment for enhancement in firm performance. This assertion
306 is consistent with the line of thought of several researchers. Schivardi & Viviano (2011) found that entry
307 barriers are accompanied by considerably greater profitability and lesser efficiency of existing firms. Sharma
308 & Gadenne (2010) demonstrated that prevailing organizations' capacity for creating barriers to entry enables
309 amplified opportunities for advancing their corporate performance and that the extent of executing quality
310 management is positively related to entry barriers, diminishing the depth of threat of entry that could arise from
311 new competitors. Sharma & Gadenne (2010), additionally demonstrated that organizations with great depths of
312 managerial commitment to quality management and those that closely focus on the needs of customers have a
313 proclivity for enhancing their competitive position. Cool, Röller & Leleux (1999) demonstrated that potential
314 rivalry substantially diminished the profitability of organizations in the pharmaceutical industry in a study that
315 spanned a twenty-year period.

316 The effectiveness of entry barriers can be influenced by a number of moderating variables. The effectiveness
317 of capital as a source of entry barrier is critically contingent upon its durability (Eaton & Lipsey, 1980). Eaton
318 & Lipsey (1980) defined the durability of capital as a particular capital commitment to a market over periods
319 of time (intertemporal), in amalgamation with reducing costs. They, further, posited that an active strategy
320 regarding capital durability and capital replacement is essential for maintaining a firm's market power position.
321 The effectiveness of regulations as an entry barrier can be mitigated by corruption. Dreher & Gassebner
322 (2013) examined whether bribery and corruption diminish the unfavorable effects of regulations on entry into
323 exceedingly regulated economies and demonstrated that corruption makes it easier for firms to enter highly
324 controlled economies. Schnell (2004) found that an industry's environment, and an entrant's goals, attributes,
325 and strategies impact the success of entry barriers in impeding entry into the unregulated airline industry.

326 9 d) The Threat of Substitutes

327 Substitutes are detrimental to the long-run profitability of an industry. Porter (1980) posited that substitutes
328 constrain the profit potential of an industry by instituting an upper limit on the prices organizations in
329 the industry can put in place. The greater the attractiveness of the price-performance tradeoff proffered by
330 substitutes, the stiffer the lid on the profits of the industry (Porter, 1980).

331 Several other studies substantiate Porter's overall postulations about the threat of substitutes. Ganitiya (2013)
332 observed that the growth in the volume of production of cassava and corn as substitutes for rice in Indonesia
333 may affect the quantity of rice imported. Forman, Ghose, & Goldfarb (2009) demonstrated that the parameters
334 in prevailing theoretical paradigms of channel substitution including cost of offline transportation, cost of online
335 disutility, and prices of products, available offline and online, interrelate to govern consumers' preference for
336 channels. On the basis of empirical observation, Forman, & Goldfarb (2009) investigated the tradeoff between
337 the advantages of purchasing online and the advantages of purchasing in a local retail outlet and demonstrated
338 that when a retail store commences operation locally, consumers replace online buying with offline purchasing,
339 even when they controlled for productspecific choices by geographic location. They further demonstrated that the
340 entry of offline retail stores diminishes consumers' sensitivity to price discounts offered by online stores. Lipatov,
341 Neven, & Siotis (2021) observed that in a situation where by organizations execute competition on the basis of
342 quality-enhancing promotion and prices in markets for differentiated goods, the entry or emergence of a closely
343 perfect substitute to any of such goods, for instance, a generic variety of a pharmaceutical product, deepens
344 competition on the basis of price but relaxes rivalry on the basis of product promotion.

345 Substitutes for a product, if currently absent, will definitely evolve from technological changes. Goldberg
346 (1970) posited that, in the long run, technological transformations will generate products that constitute decent
347 substitutes for a specified product in several of its markets.

348 Products that are strategic substitutes can have ripple effects on competitors' actions in multimarket
349 oligopolies. Bulow, Geanakoplos & Klemperer (1985) demonstrated that when competitors products are strategic

350 substitutes, and they compete in multimarket oligopoly, a firm's action in one market can transform competitor's
351 strategies in another market by impacting its marginal costs in that other competitive market.

352 10 e) Industry Rivalry

353 Porter (1980) posited that rivalry among prevailing competitors takes the conversant shape of competing for
354 position by applying marketing strategies such as a price war, advertising skirmishes, the introduction of new
355 products, and improved customer services or guarantees. Rivalry happens for the reason that one or more
356 competitors either sense pressure or perceive the prospect of enhancing its competitive position. Porter (1980)
357 went further to elucidate the conditions necessary and sufficient for intense rivalry. He posited that when there
358 are numerous players in an industry, the odds of having mavericks that will ignite rivalry is great, given that some
359 firms may have confidence in their ability to engender moves devoid of being observed. Even if there are relatively
360 few firms, if they possess approximately the same magnitude of resources for a continuous and robust retaliation,
361 they may become susceptible to taking on each other. On the other hand, when an industry is associated with
362 a high degree of industry concentration or is dominated by a single or a few firms, the equilibrium of relative
363 power will be sustained for a more extended period and would also be visible to every participant in the industry.
364 Porter (1980) asserted that there exists additional factors that could provide fertile grounds for intensive industry
365 rivalry including, slow industry growth (by constituting a destabilizing power for competition), high fixed costs
366 (by creating sturdy problems for all firms to plug capacity, frequently leading to quickly rising price cuts) and
367 whether the industry product is viewed as a commodity or a differentiated product or otherwise. A plethora
368 of scholarly works supports the expositions of Porter (1980) with regard to industry rivalry. Ferrier, Smith &
369 Grimm (2017) showed that industry leaders would be more disposed to encounter erosion of their market share
370 and/or deposition of their industry position relative to industry challengers in situations where they exhibit less
371 aggression in competition, undertake more manageable range of actions, and execute competitive activities in
372 a slower fashion. Mas-Ruiz & Ruiz-Moreno (2011) examined rivalry at the level of strategic groups within the
373 Spanish banking industry and demonstrated that amplified rivalry and diminished performance characterized
374 organizations fitting a strategic group that encompasses smaller organizations.

375 Industry rivalry has consequential implications for industry profitability. Cool, Röller, & Leleux (1999) showed
376 that, during the 1960s, competition among the firms studied did not immensely impact the profitability of firms,
377 nevertheless, in the course of the 1970s, rivalry among incumbents posed a progressively detrimental effect on
378 firms' profitability. Cool & Dierickx (1993) demonstrated that an examination of the United States pharmaceutical
379 industry in the course of the period 1963 to 1982 showed that a considerable decline in industry profitability is
380 sturdily related to growing competition. They further demonstrated that snowballing rivalry is connected with
381 variations in strategic group structure and an attendant change from intra-group competition to inter-group
382 rivalry. Teixeira Dias et al (2020) observed that rivalry and organizational size impacted competitive position,
383 while dynamism, on the other hand, had minimal effects on competitive position. Chatain & Zemsky (2011)
384 demonstrated that rivalry interrelates significantly with other competitive forces impacts on industry potential
385 profitability.

386 IV. Further Extensions to the Porter's Model of Industry Attractiveness a) Optimal Capital Structure of the
387 Industry Numerous studies have documented the existence of an optimal capital structure. In other words, a
388 specific combination of debt and equity or a mix of capital structure that maximizes the value of the firm. Given
389 certain conditions, Miller (1977) showed that a single optimal level of aggregate debt prevails for the entire
390 corporate sector or industry. However, he also posited that debt and value are independent at the specific firm
391 level. Modigliani and Miller (1958) investigated the importance of taxes for the irrelevance of equity versus
392 debt in the capital structure of the firm and, together with Miller (1977) demonstrated that that under certain
393 assumptions, the optimal capital structure can be complete debt finance because of the preferential treatment of
394 debt in relation to equity in the tax laws. Nevertheless, issuing equity does not amount to leaving shareholders'
395 money on the table in the form of superfluous company income tax expenditures. Miller (1977) demonstrated
396 that an organization could generate higher after-tax income by elevating the debt-to-equity ratio and utilize
397 this supplementary income to accomplish a larger payout to bondholders and stockholders. Still, this financial
398 transaction would not certainly result in an increment in the value of the organization. This is because as equity
399 is replaced with debt, the percentage of firm payouts by way of interest on debt capital increase in relation to
400 payouts by way of dividends and gains on equity capital (Miller, 1977). If taxes on interest payments are higher
401 than that on dividends as usually is the case, the advantage of debt finance to the organization is eliminated. In
402 the final analysis we would end up with an optimal capital structure at which point there is no incentive to further
403 increase debt or equity and that which maximizes the value of the firm (Miller, 1977). Other empirical works
404 provide additional evidence in support of the existence of an optimal capital structure. Flath & Knoeber (1980)
405 provided empirical abutment to theoretical proclamations that taxes and costs of financial distress do suggest an
406 optimal capital structure, at least for industries. Lew & Moles (2016) investigated indications of the reality of an
407 optimal capital structure and found evidence for the incidence of orderly patterns in debt ratios and approaches
408 that firms adopt to regulate their capital structures. They asserted that these observations constituted implicit
409 evidence for the paradigm of optimal capital structure and suggested that firms should seek to establish the
410 appropriate capital structure predicated on industry and republic factors.

411 Although it is established that an optimal industry capital structure exists, whether firms actively seek to

11 B) THE POWER OF LENDERS

412 optimize their capital structure is another issue. Bowen, Daley & Huber (1982) demonstrated that companies
413 exhibited a statistically substantial propensity to navigate towards their industry average over both five-year and
414 ten-year periods of time. Myers (1984) contrasted two approaches to thinking about capital structure, including
415 the static tradeoff framework and the pecking order framework. In the static tradeoff theory, the firm is perceived
416 as setting a target debt-to-value ratio and steadily navigating towards it, in a manner closely related to the methods
417 that a firm alters dividends to locomote to a targeted payout ratio. On the other hand, in the pecking order
418 framework, the firm has a preference for internal over external financing, and debt over equity whenever it sells
419 financial securities so that in the pecking order model, the firm does not possess any precisely-defined targeted
420 debt-to-value ratio. Myers (1984) further argued that the pecking order theory accomplishes at the minimum as
421 adequately as the static tradeoff theory in elucidating existing knowledge of financing preferences and their mean
422 effects on the prices of financial securities.

423 The extant capital structure that is observable among industries does vary from industry to industry (Bowen,
424 Daley & Huber, 1982; O'Reilly Media Inc, 2022) and is determined by specific industry attributes. This may
425 imply that either the optimal capital structure varies from industry to industry and/or that not all industries are
426 able to attain the optimal capital structure. Industry characteristics can exert a bearing on a firm's ability to
427 navigate towards the optimal capital structure or a firm's preferences for capital structure. Numerous researchers
428 have argued that, industry-specific attributes along with firm-level elements, can impose a noteworthy bearing
429 on the financial choices of firms (Harris and Raviv, 1991; MacKay and Phillips, 2005). Saxena & Bhattacharyya
430 (2022) explicitly analyzed the influence of industry-level characteristics on capital structure decisions of firms and
431 found that an increment in industry munificence motivates firms to reduce their reliance on external financing
432 and additionally that firms in a comparatively concentrated industry that is associated with more excellent
433 opportunities for growth elevate their dependence on debt financing. Maksimovic (1988) demonstrated that, under
434 certain conditions, there exists an optimal capital structure, which is dependent on the degree of concentration of
435 the industry, the prevailing discount rate or cost of capital for the industry, the elasticity of demand, and other
436 associated factors that impact on market equilibrium for products generated in oligopoly industries. Degryse,
437 De Goeij & Kappert, (2012) demonstrated the existence of considerable heterogeneous intra-industry attributes,
438 portraying evidence for the fact that the degree of industry rivalry, the extent of agency skirmishes, and the
439 lack of homogeneity in the technology employed across industries are crucial determinants of the structure of
440 capital in the industry. Bancel & Mittoo (2004) found that the financial policies of firms are shaped by both their
441 international operations and the institutional environment. Kale & Shahrur (2007) found lesser levels of debt for
442 firms functioning in industries characterized by predominant occurrences of joint ventures and strategic alliances
443 with organizations in customer and supplier industries. They also found a favorable relationship between the
444 firm level of debt and the extent of concentration in industries of customer and/or supplier in consistency with
445 a negotiating attribute of debt.

446 The capital structure of a firm has consequences for the firm's investment decisions, product strategy,
447 product innovation, organizational profitability, the value of the firm, and therefore, the overall attractiveness
448 of the industry. Myers (1974) postulated that corporate financing and investment choices should be executed
449 concurrently, for the reason that both decisions intermingle in significant ways. Brander and Lewis (1986)
450 demonstrated that the capital structure of a firm might signal the credibility of its precommitment to impacting
451 strategic interaction within an industry. O'Brien (2003) proposed the necessity for organizations that seeks to
452 develop a competitive strategy founded on innovation to maintain some level of financial slack, the absence of
453 which might result in poor performance. Gill, Biger, & Mathur (2011) demonstrated that a favorable relationship
454 exists between both short-term debts to total assets and total debt to total assets and profitability in the service
455 industry. They also found a favorable relationship between short-term debt to total assets, long-term debt to
456 total assets, and total debt to total assets and profitability in the manufacturing industry. Chevalier (1995)
457 found that the announcement of leveraged buyouts (LBOs) of supermarkets elevated the firm market value of
458 local rivals of the LBO chain and that supermarket chains have a greater propensity to make an entry and
459 undertake expansions in a local market if a substantial proportion of the incumbent organization in the local
460 market implemented leveraged buyouts. Abor (2005) found a substantially favorable relationship between the
461 short-term debt to total assets ratio and return on equity for firms listed on the Ghanaian Stock Exchange but,
462 on the contrary, an unfavorable relationship between the long-term debt to total assets ratio and return on equity
463 and finally a significantly favorable relationship between the total debt to total assets ratio and returns on equity.
464 Nasimi (2016) empirically analyzed the impact of capital structure and determined that an optimal level of
465 capital structure, as well as effective application and allocation of available resources is fundamental to achieving
466 the target level of productivity in business. ??hubita & Alsawalhahn (2012) found substantially unfavorable
467 relationship between debt and profitability for industrial companies listed on the Amman Stock Exchange in
468 the course of a six-year time frame ranging from 2004 to 2009. Adeyemi & Oboh (2011) observed a significant
469 positive relationship between the preferences for the capital structure of a firm and its market value within the
470 ranks of publicly listed firms in Nigeria.

471 11 b) The Power of Lenders

472 Lenders are powerful and their tendency to portray this supremacy has various ramifications. Boot & Thakor
473 (2011) demonstrated that since lenders will institute control rights over firms, firms have a preliminary

474 management preference for financial securities that make the most of executive projectselection independence,
475 suggesting the prevalence of lenders proclivity to exercise their power over firms through debt covenants that
476 can restrict the executive capabilities of firm managers. The power of lenders is also exhibited in terms of the
477 cost of debt capital provided or the amount of loan extended. Sengupta (1998) provides evidence that firms
478 that receive high disclosure quality ratings from market or financial analysts have access to a lesser effective
479 cost of raising debt capital. Broberg, Tagesson & Collin (2010) demonstrated that firms with superior disclosure
480 practices have higher debt ratios. The power of lenders is also be reflected in the variability of the ease with
481 which firms in various industries can raise debt capital. The airline industry is characterized by excessive debt
482 load and a resultant excess capacity (Oum, Zhang & Zhang, 2000), signaling relatively more straightforward
483 access to raising desired capital for capacity expansion. The real estate industry, including real estate investment
484 trust companies (REITs) and property firms, have higher levels of debt capital because of their perceived lower
485 level of operational risk in relation to other industries (Morri & Cristanziani, 2009).

486 There are variabilities in the power and nature of lenders native to a specific industry. Large retailers can
487 substantially rely on trade credits from suppliers ??Lieberman,2014), who, because of their relatively smaller size,
488 have lower bargaining power. The financial industry, and specifically commercial banks, are uniquely blessed
489 with the breadth and depth of lenders that are available at its disposal. As I have previously suggested, deposit
490 providers or savers in commercial banks can be viewed as lenders to banks with a flexible or indeterminate
491 maturity on their loans (savings). In addition, commercial banks can access loans from the central bank (acting
492 as the lender of last resort) in the

493 The Determinants of the Attractiveness of an Industry: An Extension of The Porter's Five-Forces event of
494 unforeseeable events, financial crises or a liquidity crunch. Banks have a financing advantage over firms in other
495 industries from the perspective of having unparalleled access to lenders (savers) that are in a weaker bargaining
496 position and to statutory lenders (the central bank) that would not renege on their promise or disappoint in
497 times of adversity.

498 The power of lenders to advance loans or impose a higher cost of debt tends to be influenced by the disclosure
499 practices of firms. Sengupta (1998) furnishes indication that firms that have the privilege of great disclosure
500 quality ratings coming from financial analysts benefit from a lower effective interest cost of issuing debt. This
501 observation is in line with the debate that a policy of timely and detailed disclosures diminishes lenders' perception
502 of the risk of default for the disclosing firm, decreasing its cost of debt. Broberg, Tagesson & Collin (2010) found
503 that size, and the debt ratio are favorably related to the depth and breadth of material voluntary disclosures.
504 Given that Industry characteristics significantly influence voluntary disclosures (Broberg, Tagesson, & Collin,
505 2010); the inclination for firms in industries with a more extensive intensity of concentration to make less disclosure
506 and circumvent certain financing choices that have significant disclosure consequences (Ali, Klasa, & Yeung,2014);
507 and the variability of the power of lenders in consonance with disclosure practices ??Sengupta,1998;Tagesson &
508 Collin, 2010), then I would argue that the power of lenders must exhibit a dependency on and is at variance with
509 industry characteristics.

510 12 V. Conclusions

511 In this essay, I provided additional theoretical grounding for porter's five-forces framework. I specified the
512 elements that make the model incomplete and provided a theoretical justification for the incorporation of these
513 elements. In the final analysis, I propose that the attractiveness of an industry could be more exhaustively
514 explained by extending the five-forces framework into the seven-structure paradigm. The chief implication of
515 this extended model is that firm managers' attempt to formulate effective competitive strategies must not only
516 consider ways of dealing with the bargaining power of buyers, the bargaining power of suppliers, the threat of
517 entry, industry rivalry, and the threat of substitutes but must also account for the feasible industry optimal
518 structure of the capital with which those strategies must be implemented and the power of lenders in setting
519 constraints on the utilization of the firms capital Many finance authors assert that the cost of debt is lower than
520 the cost of equity (for example ??odigliani & Miller,1958). Therefore, a firm is likely to be more profitable,
521 the higher the level of debt that is incorporated into its capital structure, all other factors held constant. As a
522 result, a firm that can mitigate the power of lenders, by way of raising debt capital at a cheaper cost, stands a
523 chance of enhancing its profitability. The ability of commercial banks to attract cheaper financing from deposit
524 providers is fundamental to their profitability. Trujillo-Ponce, (2010) demonstrated, by the application of the
525 GMM-SYS estimator to an extensive sample of banks in Spain, that the relatively substantial profitability of
526 Spanish banks for the period studied was related to a significant fraction of deposits of customers, among other
527 factors. Although Al-Harbi (2019) reported that deposits contributed negatively to the profitability of banks,
528 this should be understood from the perspective of the interest rates paid on bank deposits, such that a rise in
529 interest rates on bank deposits will result in a lowering of banks' profits. Some large retailers develop cheap
530 sources of debt by relying on supplier credit. For instance, Walmart, a retail behemoth in the United States,
531 employs four-times more financing from suppliers than short-term debt (Lieberman, 2014).^{1 2 3}

¹The Determinants of the Attractiveness of an Industry: An Extension of The Porter's Five-Forces Framework

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