

# KNOW YOUR INDUSTRY LIFE CYCLE PHASE

## KEY FINDINGS

1. After their inception, industries go through multiple phases/stages, the main ones being growth, maturity, and decline. Many industries go through multiple cycles.
2. Each phase is characterised by somewhat predictable changes in the number of firms, output levels, prices, innovation, and uncertainty.
3. Since each phase has distinctive characteristics, firms should adopt different strategies at different phases of the ILC.

**The Issue: RI strategy rule 2 recommends adopting different strategies and leadership styles at different phases of the industry's life cycle (ILC). How can firms discern the phases of the ILC, and what strategies should they adopt during each phase?**

**Industries typically go through the stages of growth, maturity, and decline.**

- Industry life cycles are similar to product life cycles, but unlike products, industries are much less likely to die out as an industry typically comprises multiple products.
- Conceptually, an industry is assumed to reach maturity when the demand for its products peaks/stabilises and assumed to decline when there is a consistent drop in demand over the course of several years.
- A declining industry may rise again in the future due to a renewed interest in the industry's products.
  - This occurs when continuous innovation creates new uses for industry products (e.g. copper) or when the industry develops new products that recapture consumers' attention.
- Since it is difficult to predict long-term changes in demand, firms should instead aim to recognise the structural changes that happen during each phase (described below).
  - RI uses multiple measures to identify the current phase of the ILC, the main one being value-added (wages plus gross profit and depreciation) as a share of GDP.
  - RI also uses the ratio of industry-level capital expenditures to gross capital expenditures as a lead indicator.

**The number of firms, output levels, product prices, and the level of innovation and uncertainty tend to change as the industry moves from one phase to another.**

- At their inception, industries are populated by a small number of firms and are characterised by high uncertainty, extensive innovation, and high product prices.
- As the industry grows, the number of firms in the industry increases, output grows rapidly, and prices fall as a result. Innovation and uncertainty remain high at this stage as firms try to differentiate themselves from the competition and attract more customers.

## AUTHORS

Sabutay Fatullayev &  
André Sammartino



- In most, but not all, industries the transition from growth to maturity is accompanied by high exit rates as many firms are forced out of the industry due to their inefficiencies or lack of innovation.
  - This initial rapid decline in firm numbers at the onset of maturity does not imply the industry's decline, which is also characterised by a drop in firm numbers (called *shake-out* by the RI).
  - A dominant product design(s) will emerge in most industries before they reach maturity. Such a design combines the features and technologies that satisfy the needs of a broad class of consumers.
- In the maturity stage, output growth slows while the number and market shares of incumbents stabilise.
  - Innovation tends to be more incremental than radical in this stage. Consequently, the high levels of variety in innovations and strategies typical of growth industries are not usually observed in mature industries.
- The decline stage is characterised by a drop in demand for industry products, reductions in the production capacities of large firms, and the exit of many firms.

***A number of factors affect firms' survival chances as the industry ages.***

- On average, early entrants and larger firms have a higher survival rate.
- First-mover advantages are often attributable to technological leadership, control of scarce assets such as process inputs or space, and the need for the late entrants to spend extra resources to attract customers away from the first-movers.
  - Access to complementary strategic assets such as distribution channels and strong organisational linkages can give early entrants an additional advantage over late entrants.
  - In industries with intense technological activity, however, new entrants may have higher survival rates as the technology becomes obsolete quickly. Additionally, evidence suggests first-mover advantages have been decreasing over time.
- Continuous innovation and the speedy adoption of new technologies and manufacturing techniques are other crucial factors that can improve firms' chances of survival (also see Rule 3 practice note).
- Having prior experience in a related industry also increases the odds of survival.
- In declining industries, small size is likely to become a liability unless the company serves a niche customer group that is price insensitive.

***Since each ILC phase has distinct characteristics, they require different strategies to ensure the firm's survival and achieve sustained profitability.***

- Radical innovation and R&D spending are especially important during the embryonic and growth stages of the industry's life cycle. In these stages, the strategic focus should be on product design rather than plant design.
  - Advertising and media coverage to increase customer awareness early on is also likely to improve survivability.

- In mature industries, good manufacturing skills/resources and production efficiency become more important. In this stage, the strategic focus should be on process/plant design to improve efficiency (while still making incremental innovations) as declining prices reduce profit margins.
- Unless serving niche markets, firms should also adopt the elements from the dominant product design to appeal to a broader customer base.
- With respect to the timing of entry, evidence suggests there is a window of opportunity after the emergence of a dominant product *category* but before the emergence of a dominant product design that is particularly advantageous.

***Devising a successful strategy in declining industries is trickier and requires firms to correctly estimate the intensity of future competition.***

- The volatility and the profitability of the *end-game* depend on how many firms remain in the industry and how fiercely they fight over shrinking sales.
- Therefore, a successful strategy requires taking into account the *competitors' perception* of future demand for industry products as it significantly affects whether they exit the industry or stay and fight.
  - Exit barriers of competitors (e.g. having specialised plants that are hard to sell) will also affect their willingness to, and speed of, exit. Remaining in an industry that comprises firms with high exit barriers is unlikely to be profitable.
- Staying in a price-sensitive industry is likely to be costlier than staying in a price-insensitive industry as the declining demand will likely push firms to reduce prices in the former case. Brand loyalty and favourable position can even earn the company above-average profits in the latter case.
- In general, companies in declining industries need to ask whether their core competencies match the remaining pockets of demand.
  - If it doesn't, an early exit is likely the best strategy.
  - If it does, staying in the industry is likely to be profitable provided that the company can achieve a leadership position or become a niche competitor through selective divestment while waiting for the start of the next industry cycle.
  - If it is unclear when the next cycle will start (i.e. when the demand will pick up), firms can diversify into a profitable industry that requires similar core skills and resources until uncertainties are resolved.
- These decisions should be evaluated in conjunction with the companies' other needs (e.g. is the declining industry a part of the company's vertical chain etc).