Question #1 of 33

Question ID: 1576452

After completing a thorough industry analysis, which of the following is *most likely* an additional element an analyst should examine when analyzing a specific company within the industry?

A) Competitive strategy. ✓

B) Power of buyers. ✗

C) Threat of entry. ✗

Explanation

Company analysis involves examining a specific firm's financial condition, products and services, and competitive strategy (cost leadership or differentiation). Industry analysis should include examining competitive forces such as the threat of entry and the power of buyers.

(Module 46.2, LOS 46.e)

Question #2 of 33

Question ID: 1577366

Adrian Martin, CFA, is tasked with evaluating profitability for a mature industry in the textile space. Given that the industry consists entirely of publicly traded companies, the *best* measure for her to use is:

A) return on invested capital. ✓

B) gross profit margin. ✗

C) return on equity. ✗

Explanation

Return on invested capital measures return (after taxes) on a base of total invested capital (debt and equity). Because it accounts for total capital structure, it is better than return on equity (which only accounts for equity capital). Gross profit margin, which is equal to sales less cost of goods sold divided by sales, does not assess total profitability because there are myriad other costs beyond just cost of goods sold.

(Module 46.1, LOS 46.c)

Question #3 of 33

Question ID: 1577359

If an investor is looking for exposure to more industry-specific risk and less company-specific risk, a financial advisor is *most likely* to recommend which of the following approaches?

A) Smaller investments in fewer companies across many industries.

B) Larger investments in fewer companies within a targeted industry.

C) Smaller investments in several companies within a targeted industry.

Explanation

A good investment strategy for gaining exposure to more industry-specific risk and less company-specific risk is to make smaller investments in many companies within the same targeted industry.

(Module 46.1, LOS 46.a)

Question #4 of 33

Question ID: 1576445

Which of the following types of industries is typically characterized by above-normal expansion in sales and profits independent of the business cycle?

A) Defensive.

B) Counter-cyclical.

C) Growth.

Explanation

A growth industry is typically characterized by above-normal expansion in sales and profits independent of the business cycle.

(Module 46.1, LOS 46.c)

Question #5 of 33

Question ID: 1577365

An industry has a Herfindahl-Hirschman Index (HHI) of 2,740. An implication of this measure is that the industry will *most likely* have:

A) greater competitive intensity.

B) less pricing power.

C) greater profitability.

Explanation

An industry with an HHI above 2,500 is considered highly concentrated. High concentration implies greater profitability (for the companies in the industry), greater pricing power, and less competitive intensity.

(Module 46.1, LOS 46.c)

Question #6 of 33

Question ID: 1577374

Which of the following statements is *most accurate* regarding a firm that chooses to employ a focus-based competitive strategy?

A) It is often a hybrid strategy, as it may involve elements of both cost leadership and differentiation.

B) The appeal is for customers who are willing to pay more for perceived value.

C) The target is a wide range of customers whose needs may differ considerably.

Explanation

A focus (or niche) strategy can be thought of as hybrid, as it contains elements of both cost leadership and differentiation. Companies whose customers will pay more for perceived value are more likely to pursue a differentiation strategy. The target for a focus strategy is on a narrower (rather than wide) range of customers.

(Module 46.2, LOS 46.e)

Question #7 of 33

Question ID: 1577373

Which of the following competitive strategies lends itself most to industries where product offerings are relatively stable and the rate of innovation is slow?

A) Differentiation.

B) Focus.

C) Cost leadership.

Explanation

A cost leadership strategy is one where firms look to generate profits through lower sale prices (to attract and maintain customers) and lower production costs. If product offerings are relatively stable and innovation is slow, cost leadership is an appropriate strategy.

(Module 46.2, LOS 46.e)

Question #8 of 33

Question ID: 1577362

How would a commercial industry classification system provider classify a firm with two business lines, with one line representing 65% of its total revenue and the other representing 35%?

A) The firm would be classified into two business lines based on a 65/35 split.

B) The firm would be classified equally into the two business lines.

C) The firm would be classified into the line that is associated with 65% of its revenue.

Explanation

A firm with multiple business lines, with one of them representing more than 60% of its revenue, will be classified into that single business line. Here, with one line representing 65%, the entire firm will be put into that business line for classification purposes.

(Module 46.1, LOS 46.b)

Question #9 of 33

Question ID: 1577364

An analyst is using the Herfindahl-Hirschman Index (HHI) to evaluate industry concentration. The industry has four firms with the following market shares: 45%, 25%, 20%, and 10%. This industry's concentration will be considered:

A) moderate.

B) low.

C) high.

Explanation

The HHI of this industry is equal to the summation of the squares of each market share. HHI = (45 × 45) + (25 × 25) + (20 × 20) + (10 × 10) = 3,150. An HHI greater than 2,500 is indicative of high concentration. Low concentration is less than 1,500, and moderate concentration is between 1,500 and 2,500.

(Module 46.1, LOS 46.c)

Question #10 of 33

Question ID: 1577363

If a company shows relatively stable demand for its services through natural fluctuations in the overall economy, the company will be considered a:

A) defensive company.

B) growth company.

C) cyclical company.

Explanation

A defensive company shows stable demand for its products and services, even as business cycles trend from expansionary to contractionary to recovery, and so on. A cyclical company will exhibit fluctuating demand based on what is happening with the economy. Stable demand is not indicative of a growth company.

(Module 46.1, LOS 46.b)

Question #11 of 33

Question ID: 1577356

An analyst is reviewing an industry and its associated barriers to entry and bargaining power of suppliers. This assessment of industry profitability and competitiveness is a part of which step of the industry and competitive analysis process?

A) Analyze the industry structure.

B) Define the industry.

C) Survey the industry.

Explanation

Of the five steps of industry and competitive analysis, *analyzing the industry structure* would include using frameworks like Porter's Five Forces (which includes barriers to entry and bargaining power of suppliers) to assess competitiveness and profitability. Defining and surveying the industry are steps in the process, but they are not where the action in the narrative is performed.

(Module 46.1, LOS 46.a)

Question #12 of 33

Question ID: 1577360

In differentiating between an industry and a sector, an analyst may describe transportation and airlines in what manner?

A) Transportation is the sector, and airline is the industry.

B) Airline is the sector, and transportation is the industry.

C) Both airline and transportation are industries.

Explanation

An industry is identified by the products it produces and services it provides. A sector is a grouping of similar industries. Transportation is a sector, and airline is an industry within the transportation sector.

(Module 46.1, LOS 46.b)

Question #13 of 33

Question ID: 1576449

The competitive forces identified by Michael Porter include:

A) power of existing competitors and threat of entry.

B) rivalry among existing competitors and power of buyers.

C) threat of substitutes and rivalry among suppliers.

Explanation

Porter's five competitive forces are: (1) rivalry among existing competitors; (2) threat of entry; (3) threat of substitutes; (4) power of buyers; (5) power of suppliers.

(Module 46.2, LOS 46.d)

Question #14 of 33

Question ID: 1577368

Which of the following barriers to entry will increase the competitiveness of the companies within an industry?

A) Pre-existing customer loyalties.

B) Low up-front capital requirements.

C) Significant regulatory costs.

Explanation

The higher the threats to entry, the more competitive the industry becomes. If up-front capital requirements are low, it makes it easier for outside companies to enter the industry and compete with the companies already in the industry. Significant regulatory costs will deter outside companies from trying to enter, as will pre-existing customer loyalties.

(Module 46.2, LOS 46.d)

Question #15 of 33

Question ID: 1576443

Which of the following types of industries is typically characterized by stable performance during both expansions and contractions of the business cycle?

A) Defensive. ✓

B) Growth. ✗

C) Cyclical. ✗

Explanation

A defensive industry is typically characterized by stable performance during both expansions and contractions of the business cycle.

(Module 46.1, LOS 46.b)

Question #16 of 33

Question ID: 1576451

A firm that pursues a differentiation strategy is *most likely* to emphasize:

A) gains in market share. ✗

B) market research. ✓

C) operating efficiency. ✗

Explanation

A firm that follows a product or service differentiation strategy needs to emphasize market research to identify needs for which customers are willing to pay a premium. Market share and operating efficiency are more of a focus for firms that pursue a low-cost strategy.

(Module 46.2, LOS 46.e)

Question #17 of 33

Question ID: 1576442

Commercial index providers typically classify companies by:

A) principal business activity.

B) statistical grouping.

C) sensitivity to business cycles.

Explanation

Commercial providers such as Standard and Poor's and MSCI Barra classify companies according to their principal business activity and the products and services they provide.

(Module 46.1, LOS 46.b)

Question #18 of 33

Question ID: 1576441

Commercial industry classification systems such as the Global Industry Classification Standard (GICS) typically classify firms according to their:

A) principal business activities.

B) correlations of historical returns.

C) sensitivity to business cycles.

Explanation

Commercial providers of industry classification systems such as the GICS classify firms according to principal business activity, such as Consumer Staples, Financial Services, or Health Care.

(Module 46.1, LOS 46.b)

Question #19 of 33

Question ID: 1577371

An analyst studying the defense industry will focus on political influences in a PESTLE analysis for which of the following reasons?

A) Defense spending is the number-one priority for governments.

B) The primary buyers are governmental entities.

C) Political parties determine whether or not to spend on defense.

Explanation

It is an accurate statement that governments are not only the primary, but also often the only buyers for the defense sector. Defense spending is an important priority, but not necessarily the top priority. Political parties may influence how much is spent on defense, but it is not a question of whether or not to spend on defense.

(Module 46.2, LOS 46.d)

Question #20 of 33

Question ID: 1577367

An analyst develops a style box that categorizes industries based on growth rate and sensitivity to economic business cycles. Which of the following industries will *most likely* land in the box for (higher) growth and defensive sensitivity to cycles?

A) Biotechnology. ✓

B) Utilities. ✗

C) Crude oil production. ✗

Explanation

The growth rate category can be further classified as mature versus growth. The business cycle sensitivity category can be further classified as cyclical versus defensive. Biotechnology is most likely considered growth and defensive. Utilities are mature and defensive. Crude oil production is mature and cyclical.

(Module 46.1, LOS 46.c)

Question #21 of 33

Question ID: 1576447

The threat of substitutes is *most likely* to be low for a firm that:

A) operates in a fragmented market with little unused capacity. ✗

B) produces a commodity product in an industry with significant unused capacity. ✗

C) produces a differentiated product with high switching costs. ✓

Explanation

The threat of competition from substitute products is likely to be low for a firm that produces a differentiated product with high switching costs. Unused capacity and low industry concentration (a fragmented market) tend to intensify rivalry among industry competitors but are not directly related to the threat of substitutes.

(Module 46.2, LOS 46.d)

Question #22 of 33

Question ID: 1576023

Industry analysis is *most likely* to provide an analyst with insight about a company's:

A) competitive strategy.

B) financial performance.

C) pricing power.

Explanation

Industry analysis provides a framework for an analyst to understand a firm in relation to its competitive environment, which determines how much pricing power a firm has. Competitive strategy and financial performance are aspects of company analysis.

(Module 46.1, LOS 46.a)

Question #23 of 33

Question ID: 1576450

An aggressive price reduction to gain market share is *most likely* to be associated with a:

A) product differentiation strategy.

B) service differentiation strategy.

C) cost leadership strategy.

Explanation

Michael Porter identified two competitive strategies: cost leadership and product or service differentiation. A firm that uses a cost leadership or low-cost strategy seeks to have low production costs that will enable it to offer lower prices than its competitors to protect or gain market share. A product or service differentiation strategy seeks to gain a price premium for its products by making them distinctive to the consumer.

(Module 46.2, LOS 46.e)

Question #24 of 33

Question ID: 1577370

In conducting a PESTLE analysis of external factors impacting an industry, an analyst will examine economic influences focused on trends in which types of structural measures?

A) Interest rates.

B) Unemployment rates and labor force numbers.

C) Growth in gross domestic product.

Explanation

A PESTLE analysis is used to evaluate external factors impacting an industry. These factors are political (P), economic (E), social (S), technological (T), legal (L), and environmental (E). Economic influences can be captured by examining cyclical trends (e.g., interest rates, gross domestic product) or structural trends (e.g., labor force, unemployment).

(Module 46.2, LOS 46.d)

Question #25 of 33

Question ID: 1577372

Company X runs a series of high-end hotels in the Northeastern United States. The average room rate per night is higher than any other hotel in the region. Which of the following *best* allows the company to build upon its differentiation strategy?

A) Economies of scale and low variable costs.

B) Strong cost controls, which allow the company to maintain profit margins.

C) A culture of strong customer experience.

Explanation

A company running high-end hotels with high average room rates is executing a differentiation strategy, where customers see value in paying more for a product or service. A culture of strong customer experience lends itself to this strategy. Economies of scale, low variable costs, and strong cost controls are needed with a cost leadership strategy.

(Module 46.2, LOS 46.e)

Question #26 of 33

Question ID: 1576448

Economic profits are *most likely* to be earned by firms in an industry that is characterized by:

A) low threat of substitutes and high rivalry among existing competitors.

B) high barriers to entry and low power of buyers.

C) high power of suppliers and low threat of entry.

Explanation

High barriers to entry (low threat of entry) and low power of buyers both increase the potential for economic profits within an industry. The five forces that shape industry competition are rivalry among existing competitors, threat of entry, threat of substitutes, power of buyers, and power of suppliers. The stronger any of these forces are within an industry, the less potential that industry has to generate (or continue to earn) economic profits.

(Module 46.2, LOS 46.d)

Question #27 of 33

Question ID: 1576444

Food, beverage, and utility companies are examples of:

A) cyclical industries. ✗

B) declining industries. ✗

C) defensive industries. ✓

Explanation

Food, beverage, and utility companies provide basic necessities of life and are considered to be defensive industries. In a recession, the demand for their products will not fall as much as for some of the other industry groups.

(Module 46.1, LOS 46.b)

Question #28 of 33

Question ID: 1577361

A commercial industry classification system has a hierarchical structure: economic sectors, business sectors, industry groups, industries, and activities. Which of the following classifications does this represent?

A) Refinitiv Business Classification (TRBC). ✓

B) Industry Classification Benchmark (ICB). ✗

C) Global Industry Classification Standard (GICS). ✗

Explanation

This is the hierarchical structure for the TRBC classification system: economic sectors, business sectors, industry groups, industries, and activities. For ICB, it is this: industries, supersectors, sectors, and subsectors. For GICS, it is this: sector, industry groups, industries, and subindustries.

(Module 46.1, LOS 46.b)

Question #29 of 33

Question ID: 1577375

Regarding competitive strategy and Porter's Five Forces, the bargaining power of customers can be overcome by successfully implementing which type of strategy?

A) Cost leadership and focus. ✗

B) Differentiation and cost leadership. ✗

C) Cost leadership, differentiation, and focus. ✓

Explanation

Firms implementing all three strategies (cost leadership, differentiation, and focus) may overcome the bargaining power of customers. Cost leadership firms can benefit by the customers' inability to drive down prices beyond the costs of the marginal producer. Differentiation firms and focus firms can take advantage of the customers' inability or unwillingness to shop around or switch suppliers.

(Module 46.2, LOS 46.e)

Question #30 of 33

Question ID: 1576446

Factors that increase competition in an industry *most likely* include:

A) low barriers to entry, high concentration, and high unused capacity. ✗

B) low barriers to entry, low concentration, and high unused capacity. ✓

C) high barriers to entry, low concentration, and low unused capacity. ✗

Explanation

Low barriers to entry increase competition as more firms can enter the business. Industries that are fragmented and have unused capacity tend to be highly competitive as they fight for market share and attempt to utilize excess manufacturing resources.

(Module 46.2, LOS 46.d)

Question #31 of 33

Question ID: 1577369

An analyst studying an industry notices that the rivalries among the companies in the industry are fairly significant. Which of the following characteristics of the industry supports the analyst's assessment?

A) Fixed costs are low relative to variable costs.

B) The costs to exit the market exceed the costs of staying in.

C) Product offerings are relatively unique.

Explanation

When the costs to exit a market exceed the costs of staying in, the industry's competitiveness is more significant because companies are "stuck." Unique product offerings and low fixed costs ease (rather than accentuate) competitiveness.

(Module 46.2, LOS 46.d)

Question #32 of 33

Question ID: 1577358

In an industry and competitive analysis, the industry base rate is *best* described as the:

A) average market share for each company within an industry.

B) maximum number of companies an industry can support.

C) overall baseline profitability for the industry as a whole.

Explanation

While individual companies may have greater (or lesser) profitability than their industry overall for a period of time, eventually, they will move toward the industry base rate—which is a measure of the overall baseline profitability for the industry as a whole. The base rate is not the maximum number of companies in an industry or the average market share for each company within an industry.

(Module 46.1, LOS 46.a)

Question #33 of 33

Question ID: 1577357

As part of an industry and competitive analysis, an analyst first defines and then surveys an industry. Which of the following assessments will be made as part of the survey step?

A) The growth rate of the industry over the last several years.

B) Political and economic impacts on the industry.

C) The geographical region in which the industry operates.

Explanation

Surveying the industry involves assessing its size, profitability, growth, and market share trends. Political and economic impacts are evaluated as part of the *examine external influences* step, while the geographical region is assessed in the *define the industry* step.

(Module 46.1, LOS 46.a)