Types of Industries & Prospects for Investors

Tel: +94 (11) 2 131 000

In the previous discussion, we analysed the business cycle and identified the industries that could outperform others at different stages of the cycle. In addition, industries could be classified according to the likely prospects for investors.

Growth Industries

Industries which are expected to grow significantly compared to the economy and other industries are called growth industries. The growth may occur regardless of economic conditions. However the prospects of the companies belonging to growth industries tend to be relatively volatile and uncertain. Therefore from an investment point of view the risk involved is greater. Investors should be willing to accept extra risk in order to invest in a growth industry.

However there is the possibility of earning exceptional returns by investing in these companies. Therefore generally the stocks in the growth industries are traded at high Price to Earning ratios (P/E). In other words investors are willing to pay a higher price compared to the profits of the company, to purchase the share.

Computer industry in 1990s was a growth industry prior to the burst of the dot com bubble. Sri Lankan telecom industry was also a high growth industry although recent stiff competition has eroded profit margins of companies (indicating the risks involved in high growth industries).

Cyclical Industries

These represent industries that are highly correlated with the business and economic cycle. They are more sensitive to economic fluctuations. They generally outperform other industries during economic expansion and underperform during contractions.

For instance the Sri Lankan hotel industry is expected perform well in the near future. Hence P/Es of the hotel sector companies are currently high (around 20 times). The reason is the investor perception that in the post-war scenario the hotel sector could experience a revival. However when economic conditions are poor the hotel & travel sector may not perform satisfactorily. Shipping, Capital goods and durable goods are also cyclical industries since the demand for these products and services tend to be high during times when the economies are booming.

Plantation industry is another example for a cyclical industry as agriculture related businesses are subject to unforeseen events such as adverse weather conditions, labour issues and diseases from time to time.

Defensive Industries

These industries, also called non-cyclical industries, are less sensitive to economic conditions. Generally they make profits regardless of the status of economic situation because these industries produce and distribute goods and services that are considered necessary.

Defensive industries tend to outperform others during economic recessions and underperform during expansions. In other words the performance of these industries is comparatively more stable and less volatile. The examples include food producers, pharmaceuticals, and tobacco and liquor industries.