

PORTER'S FIVE FORCES

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Porter's Five Forces Model "What it means for your business"

Achieving success particularly for small, medium and large businesses is synonymous with symbiotic relationship between competitors within an industry, potential competitors, suppliers, buyers and alternative solutions to the problem being addressed.

Michael Porter described a concept that has become known as the "five forces model". Using this model, business leaders can develop a strategic edge over rival firms by better understanding, the industry context in which the firm operates. Porter's approach takes an industry vista helping you to assess, at a corporate strategy level, the attractiveness of the industry to potential entrants at a given time.

- ❖ *Porter's Forces*
- ❖ *Business Context*
- ❖ *Generic Strategies*
- ❖ *Apply & Prognosticate*
- ❖ *Take the Challenge*



"If you do not take care of your competitors, your competition will."

Anil Baddi

BUSINESS CONTEXT OF PORTER'S FORCES**I. Rivalry**

As a business leader, it is quintessential to understand the competition concentration within your particular industry vertical. Some ways to measure rivalry is to watch out for patterns in Industry Concentration, fixed costs within the segment as well as overall segment growth. For example, consider a place like Champaign, IL having large numbers of firms in the same travel industry. This might lead to greater competition for same resources and customers.

II. Threat Of Substitutes

Today's global economy provides customers with more alternatives. What this means is that customers shopping for a television on www.NexTag.com can avail from more than 1200+ options. Now, consider yourself as being in business of manufacturing Television sets. Surely, your product's demand would be affected by the price change of a substitute product. Moreover, as more substitutes become available, the demand becomes more elastic since customers have more alternatives. This threat of substitutes constrains the ability of firms in an industry to raise prices.

III. Buyer Power

Let me introduce the term *monopsony*! www.businessdictionary.com defines *monopsony* as a market situation where several producers compete for the business of only one buyer. Take for example the aircraft industry, where many a times the sole customer is the government. Buyer power is very strong in these scenarios; where many firms compete for a small customer base. In such market conditions, the buyer sets the price.

Symptoms of Strong Buyer Power	Example
Buyers purchase a significant proportion of output - distribution of purchases or if the product is standardized	Type table text here. Type table text here.

Symptoms of Weak Buyer Power	Example
Fragmented buyer market – as a result, no buyer has any particular influence on product or price.	Consumer-products companies face weak buyer power because customers are fragmented and have little influence on price or product.

IV. Supplier Power

Try putting yourself in the shoes of a franchise owner of a huge burger chain, like Burger King. Who is your supplier (Brand)? Burger King of course. As a business owner, you would face a significant amount of Strong supplier power. One the other hand, if you were a supplier of raw material to a national retail store like Walmart, you would experience challenges as a supplier. So, it is important to know which side of the supply-demand equation, your business context is referring to.

Symptoms of Strong Supplier Power	Example
Significant cost to switch suppliers	Imagine yourself as a business reseller of Microsoft Solutions. You would find yourself experiencing a strong supply power.

Symptoms of Weak Supplier Power	Example
Many competitive suppliers - product is standardized	Businesses that have contracts to supply to major retail stores (example – Walmart) experience weak supplier power, particularly when the products are standardized.

V. Barriers to Entry / Threat of Entry

Suppose you a local talented company in Champaign, IL which has developed a superior product, such as a detergent. What does it take to compete with *Procter & Gamble*? The answer is a huge amount of capital investment. This is known as **Barrier to Entry**. This is one reason why we find that technology oriented companies that have easily enter the market when there is common technology and easy access to distribution channels.

EASY TO ENTER <ul style="list-style-type: none"> Common technology Access to distribution channels 	DIFFICULT TO ENTER <ul style="list-style-type: none"> Huge Capital Investment Patented Technology
EASY TO EXIT <ul style="list-style-type: none"> Saleable Assets No exit costs 	DIFFICULT TO EXIT <ul style="list-style-type: none"> Specialized Assets Huge exit costs

GENERIC STRATEGIES TO COUNTER THE FIVE FORCES

Strategy can be formulated on three levels:

- corporate level
- business unit level
- functional or departmental level.

To create a competitive advantage, a business unit level, can adopt strategies that hinge on cost leadership, differentiation and focus.

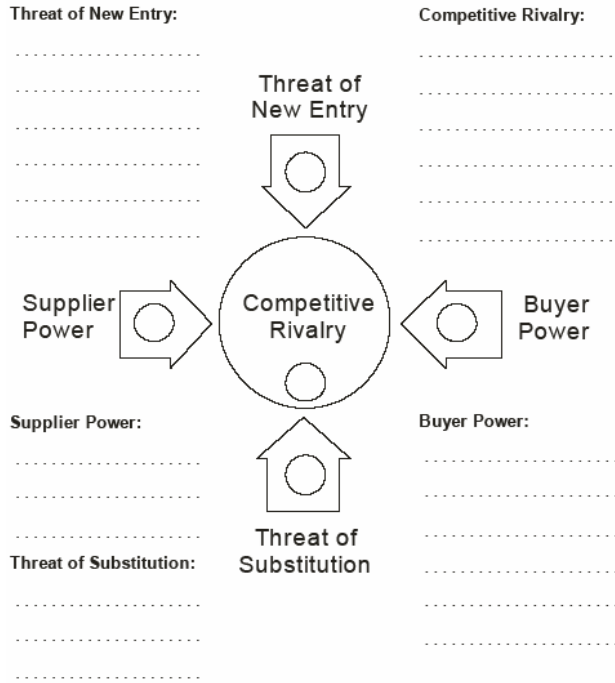
HOW YOU CAN APPLY PORTER'S FIVE FORCES TO BETTER PROGNOSTICATE YOUR BUSINESS STRATEGY

One key takeaway from this narrative would be to examine your industry as a whole with your company in mind. Remember to keep in perspective the connotation that each word (given below) has on your every day business lives.

Table Heading	
<p>SUPPLIER POWER</p> <ul style="list-style-type: none"> • Supplier concentration • Importance of volume to supplier • Differentiation of inputs • Impact of inputs on cost or differentiation • Switching costs of firms in the industry • Presence of substitute inputs • Threat of forward integration • Cost relative to total purchases in industry • Brand reputation • Geographical coverage 	<p>THREAT OF SUBSTITUTES</p> <ul style="list-style-type: none"> • Switching costs • Buyer inclination to substitute • Price-performance • Trade-off of substitutes • Alternatives price/quality • Market distribution changes • Fashion and trends • Legislative effects • Product/Service level quality • Relationships with customers • Bidding processes/capabilities
<p>DEGREE OF RIVALRY</p> <ul style="list-style-type: none"> • Industry concentration • Fixed costs/Value added • Industry growth • Intermittent overcapacity • Product differences • Switching costs • Brand identity • Diversity of rivals • Corporate stakes • Number and size of firms • Industry size and trends • Fixed v variable cost bases • Product/service ranges • Differentiation, strategy 	
<p>BUYER POWER</p> <ul style="list-style-type: none"> • Bargaining leverage • Buyer volume • Buyer information • Brand identity • Price sensitivity • Threat of backward integration • Product differentiation • Buyer concentration vs. industry • Substitutes available • Buyers' incentives • Buyer choice • Buyers size/number • Change cost/frequency 	<p>BARRIERS TO ENTRY / EXIT</p> <ul style="list-style-type: none"> • Absolute cost advantages • Proprietary learning curve • Access to inputs • Government policy • Economies of scale • Capital requirements • Brand identity • Switching costs • Access to distribution • Expected retaliation • Proprietary products • Product/Service importance • JIT scheduling • Exit barriers

PORTER'S FIVE FORCES CHALLENGE SHEET

It is my belief that true knowledge and insight comes when reading a good article is supplemented with a relevant workout. So, I urge you to take a 2 minute challenge given below and score your business on a scale 1 – 10, regularly every financial quarter. Posting the scores in regular board meetings generally has a positive impact on triaging business goals. Good luck.



SUGGESTED READING

- "Competitive Strategy" – **Michael Porter**
- "How Customers Think: Essential Insights into the Mind of the Market" - **Gerald Zaltman**
- "The Balanced Scorecard: Translating Strategy into Action" - **Robert S. Kaplan, David P. Norton**
- "One-Minute Manager" - **Spencer Johnson and Kenneth H. Blanchard**

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Feedback Letter & Information Update

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