**Theme:** 2.

**Reading:** How Competitive Forces Shape Strategy.

**Author:** Michael E. Porter.

**Introduction**

-Every industry has an underlying economic and technical structure which gives rise to certain competitive forces which shape the industry.

-Strategists must position their firm where they are best protected from these forces, or can best influence them in their favour.

-The strongest force(s) are the ones which will determine profitability in the industry.

**The Five Forces**

***1) - Threat of New Entrants***

-Firms that enter an industry can shake-up the industry to steal market share.

-The degree of threat of new entrants is determined by the barriers to entry.

**Barriers to entry:**

i) Economies of Scale.

ii) Product Differentiation.

iii) Capital Requirements.

iv) Cost Disadvantages independent of size (experience curve etc).

v) Access to Distribution Channels.

vi) Government Policy (licensing, regulation).

*New rivals are unlikely to enter an industry if:*

-Industry growth is slow.

-Incumbents have excessive resources and have lashed out at previous entrants.

***Experience Curve: Barrier to Entry?***

-Economies of scale/learning curve of labour/labour-capital substitution.

-Strategy shouldn’t be built on it.

-Only a barrier if it is kept within the firm. e.g. technical advances→debt.

***2) - Power of Suppliers***

A supplier group is powerful if:

i) Few suppliers.

ii) Unique/differentiated product: buyer would incur switching costs.

iii) No competition with related products sold to the industry.

iv) Can integrate downstream.

v) Industry is not important to them.

***3) - Power of Buyers***

A buyer group is powerful if:

i) Few buyers.

ii) Bulk buys.

iii) High fixed costs.

iv) Homogenous products.

v) Price Sensitivity of buyers → purchase selectively.

***\*Strategic Action: Choosing Buyers and Sellers\****

Choosing buyers and suppliers is a key strategic decision.

-Choosing a buyer with limited power means you retain more power. It is still possible to supply your product to powerful buyers but only if they are not price sensitive to it, or it is unique.

-Choosing a supplier with limited power is usually more difficult.

***4) - The threat of Substitutes***

-Substitute goods put a price ceiling on the good in the industry.

-The comparative value for money will also determine the price it is possible to charge.

***5) - Internal Rivalry***

Facets of internal competition:

-Price competition.

-Advertising.

-New product development.

*Intense competition occurs when:*

i) Many competitors/equally matched.

ii) Industry growth is slow.

iii) Lack of Differentiation/switching costs.

iv) High fixed costs/perishable goods.

v) Exit barriers are high.

vi) Diverse rival strategies exist.

***Formulation of Strategy***

*-Having assessed the forces and underlying causes, the strategist(s) must determine the company’s strengths and weaknesses i.e. their position against the underlying causes of the forces.*

Possible Actions:

**Positioning the Company**

-Knowing the company’s capabilities and causes of forces highlights where companies should compete and where they shouldn’t.

e.g. Dr. Pepper: Product differentiation, lower costs, existing distribution network.

**Influencing Forces**

-Changing the causes of existing forces alters the environment in the firm’s favour and makes it harder on other firms.

e.g. building brand identity, increasing scale-lowering costs.

**Exploiting Industry Change**

Anticipating changes in the industry will allow firms to adapt to a new force system before competitors and allow them to gain more power.

*Key to survival is to stake out a safe position and anticipate the changes in forces to take pre-emptive action.*