

# **Porter's Five Forces and Generic Strategies**

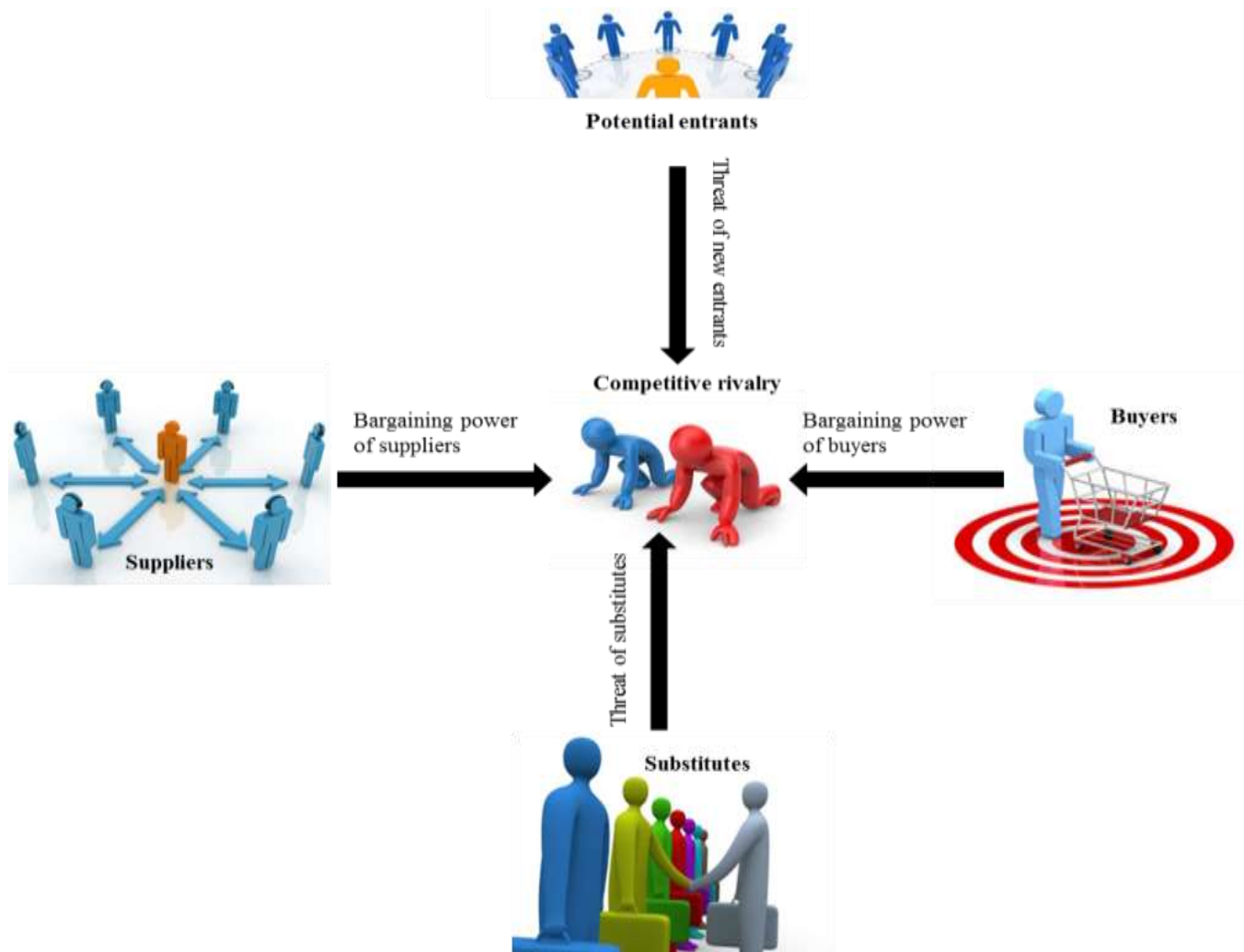
# What is the need?

- Growth in globalised competition
- To ensure competitive advantage
- Porter (1980) argues that by understanding “the competitive forces, and their underlying causes, reveals the roots of an industry’s current profitability while providing a framework for anticipating and influencing competition (and profitability) over time.”

# What are the five forces?

- The five forces model is based on the theory of determining the competitive intensity and attractiveness of a market
- The key five forces involve:
  - The threat of new entrant (dependent upon entry barriers),
  - The bargaining power of buyers,
  - Bargaining power of Suppliers, whereby the bargaining power of each group influences profitability, the availability of,
  - Threat of Substitutes which could potentially include alternatives for consumers, and the degree of,
  - Rivalry among upon existing competitors.

# What are the five forces?



# What are the five forces?

Insights and attributes into competitive industries:

- It implied micro-economic theory into just 5 major influences.
- It effectively and before its time applied 'systems thinking'.
- It showed how 'competitive rivalry' is very much a function of the other four forces.
- It helped predict the long-run rate of returns in a particular industry.
- It went beyond a more simplistic focus on relative market growth rates in determining industry attractiveness.
- It helped combine input-output analysis of a specific industry with industry boundaries via entry barriers and substitutes.
- It emphasized the importance of searching for imperfect markets, which offer more national opportunities for superior returns.

# Competitive Rivalry

- One of the most important
- Increase in pressure, time and cost!
- Factors
  - Number of Competitors
  - Market Size
  - Product differentiation
  - Power of buyers
  - Capacity utilisation
  - Cost structure
  - Exit barriers

# Competitive Rivalry

- **Benefits**
  - Differentiation
    - Research and Development
  - Lowers prices
  - Economic growth

# The threat of new entrant

- Involves organisations entering into an industry whereby they will gain market share and competition will intensify
- Six barriers to entry
  - Economies of scale
  - Product differentiation – Loyalty (Shugan, 2005)
  - Capital Requirements
  - Cost disadvantages
    - Raw materials
    - Favorable locations
    - Government subsidies
  - Distribution channels (Grimm, 2006)



# Bargaining power of customer

- Customers who **collectively** become a powerful group
- Exert pressure
- Drive down prices
- Increase the quality of good



# Bargaining power of customer

- Determinants
  - Bought in large values of quantity
  - Product or service is standard or undifferentiated
  - Buyer is large and supplier is small
  - Threats of vertical integration
    - Increases pressure to meet demands

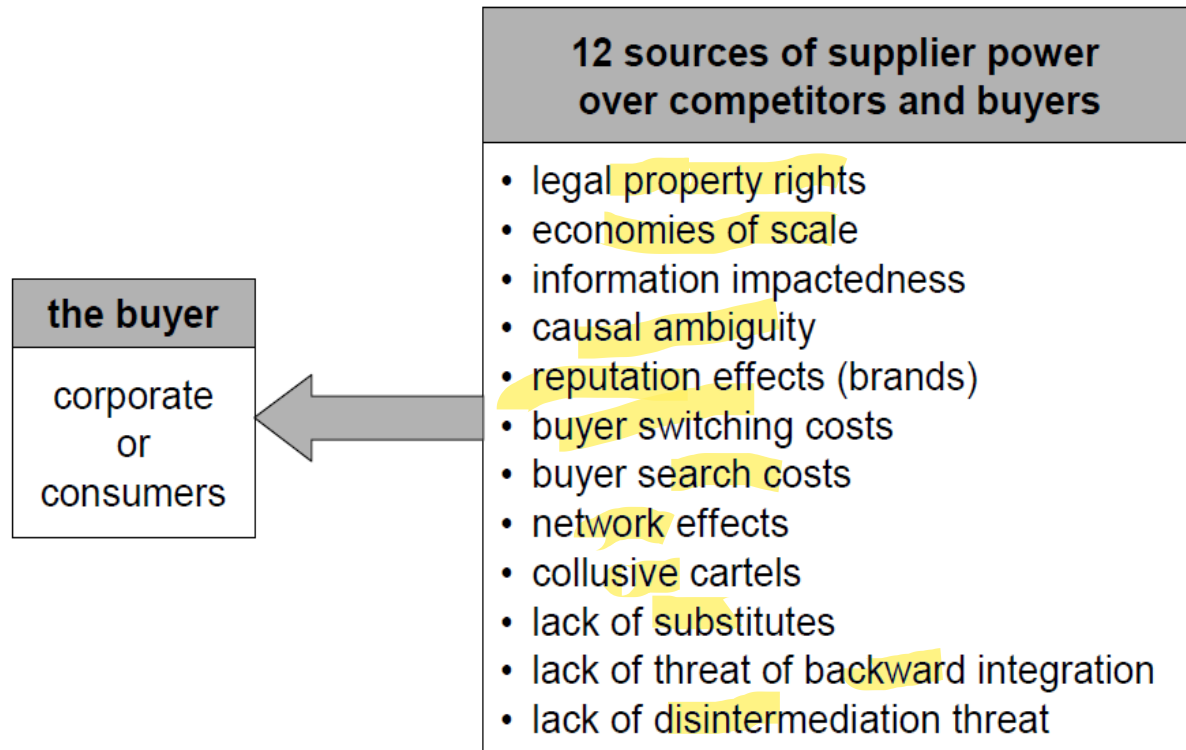
# Bargaining power of supplier

- The suppliers have power to sell their products at higher prices.
- Example: Fast Food Restaurants



# Bargaining power of supplier

- The fundamental bases of supplier power over buyers (Cox, 2001)



# Threat of substitutes

- “A substitute performs the same or a similar function as an industry’s product by a different function . . . [and] limit an industry’s profit potential by placing a ceiling on prices” (Porter, 2008: 84).
- Extent depends on:
  - Switching costs
  - Product price
  - Product quality

# Criticisms of the Five Forces

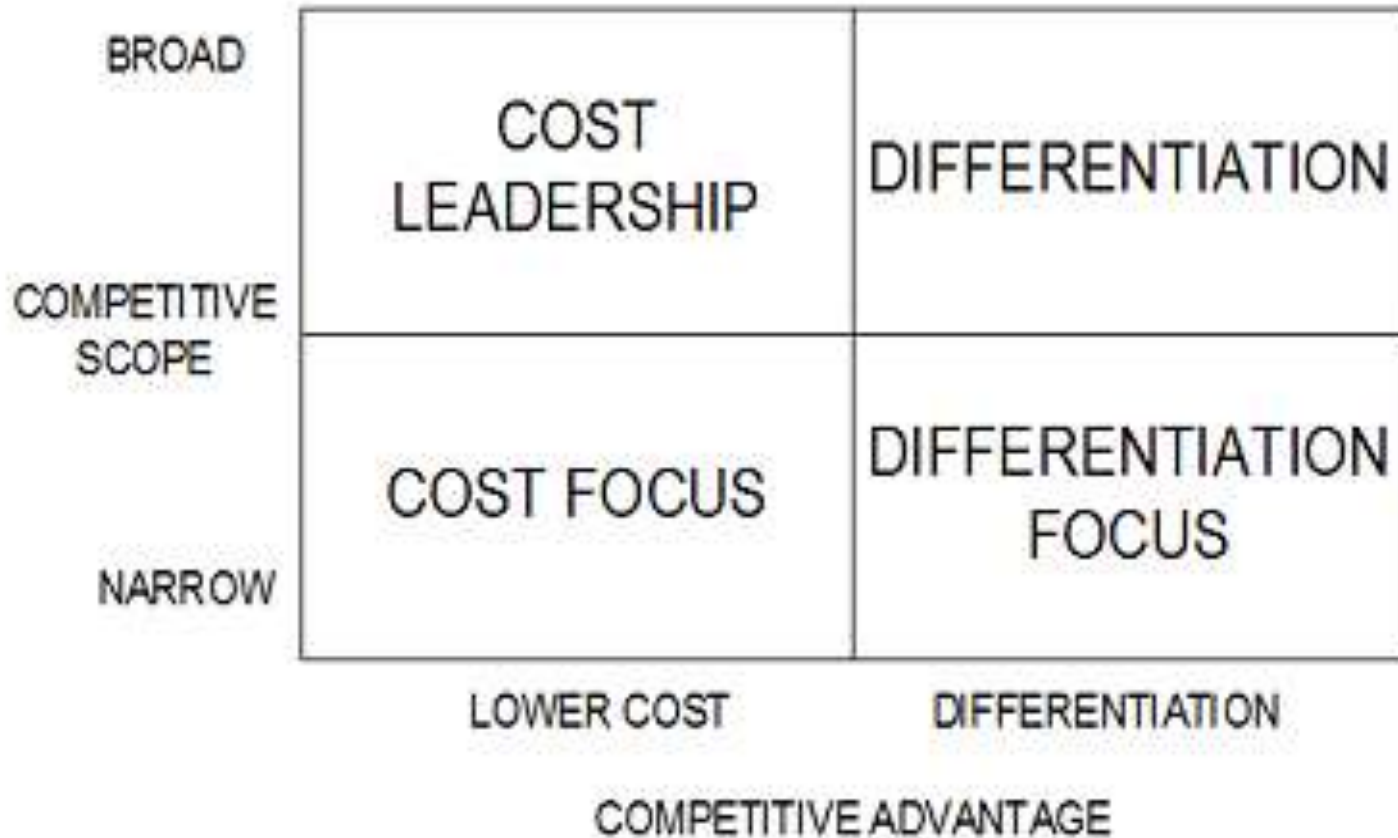
- Does not assist firms to identify and leverage unique sustainable advantages (Speed, 1989).
- Focuses on attractiveness of industries rather how firms gain an advantageous position
- Overemphasises competition and lack of cooperation
- Cannot generalise. Based on a snap shot of time

Given these criticisms it is worth mentioning that it has been suggested that “each of Porter’s five forces offers a useful ‘window’ onto industry dynamics” (MacIntosh and MacLean, 2015: 64).

# Porter's Generic Strategies

- For organisations to survive and succeed they need to adopt a competitive strategy
- Based on gaining competitive advantage
  - Gaining advantage through better value, price or benefits

# Porter's Generic Strategies



Source: Adapted from Porter (1985: 12).



# Cost Leadership

- Focuses on gaining competitive advantage by having the lowest cost in the industry
- Aim
  - To service mass market
- Techniques
  - Mass production
  - Mass distribution
  - Economies of scale
  - Technology
  - Product design

# Differentiation

- Concentrates on providing a unique product or service, developing a unique selling point (USP) to ensure they are different from their competitors
- Tailoring to individual customer segments
- Techniques
  - Extra features
  - Quality
  - Price

# Focus/Differentiation Focus

- Concentrates on a selected few target markets (focus) or seeks differentiation in its target segment
- Aim
  - Gain a competitive advantage through effectiveness rather than efficiency
- Techniques
  - Being clear in differences with competition
  - Being clear in differences with other consumers
  - Niche status

# ‘Stuck in the middle’

- Attempt to adopt all three of these strategies
- Demonstrates indecisiveness on competitive strategy
- Lack of clarity



# Criticisms: Porter's generic strategies

- Theoretical shortcomings
  - Too general. Simplistic strategy
- Fit with reality
  - Clash with empirical reality
  - Limited market knowledge
- Limited applicability
  - Not applicable for small firms/ fragmented markets / retailers
- Alternative theatrical approaches
  - Should apply a resource – based approach
  - Process is flexible

# Further reading

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