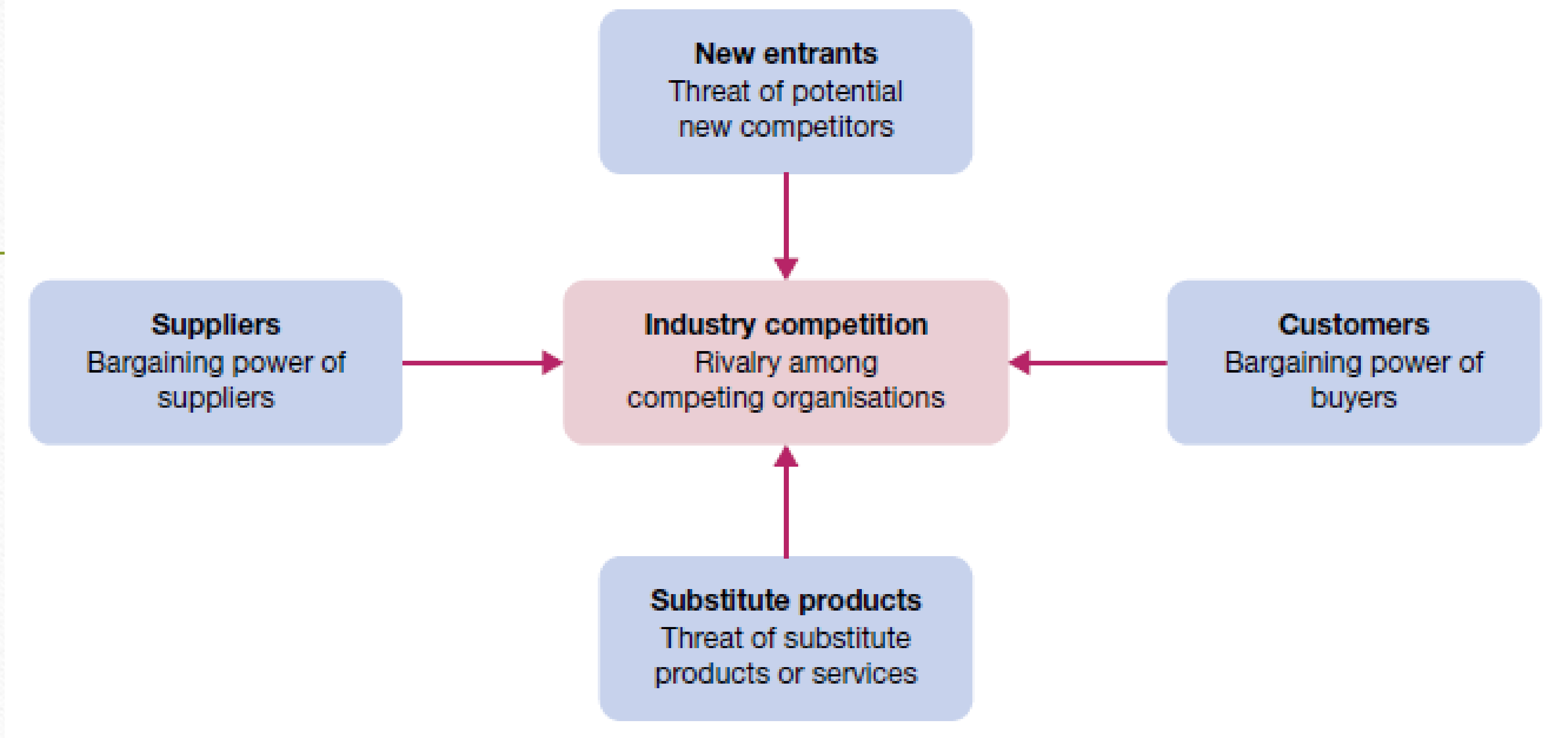
UNIT –FOUR

PART-TWO



Porter’s model of five strategic forces affecting industry competition

Michael Porter's Five Forces is a powerful competitive analysis tool to determine the principal competitive influence in a market.

- Knowing the strength of these five forces, you can develop strategies that help their businesses be more competitive and profitable.
- Looking at opportunities, you can to strengthen their organization's position compared to the other players for reducing the competitive pressure as well as generate competitive advantage.

Step-by-Step Five Forces Analysis

Identify the different factors that bring about the competitive pressures for each of the five forces:

- Who are the suppliers?
- Who are the customers?
- What are the substitute products?
- Is it difficult to enter this industry?
- Who are the major competitors in this industry?

Based on the factors identified, determine if the pressures are:

- Strong
- Moderate
- Weak

Determine whether the strength of the five forces is favorable to earning attractive profits in the industry. Using the Five Forces model can help answer the following questions:

- Is the state of competition in the industry stronger than "normal"?
- Can companies in this industry expect to earn decent profits in light of the competitive forces?
- Are the competitive forces sufficiently powerful enough to undermine industry profitability?

The bargaining power of suppliers:

- The market is conquered by a few big suppliers.
- There are no alternative products available.
- The supplier customer base is fragmented, making their bargaining power low.
- High switching costs from one to another supplier.

Possibility of supplier integration forward, to obtain higher profits and margins.

The bargaining power of Customers:

- Customers procure large volumes.
- The supplying industry consists of several small operators.
- The supplying industry is controlled with high fixed costs.
- The product has substitutes. Switching products is easy and simple.
- Switching products does not incur high costs.
- Customers are price responsive. Customers could manufacture the product themselves.

The threat of new entrants

- Economies of scale. High initial investment costs or fixed costs
- Cost advantage of existing players.
- Brand loyalty.
- Intellectual property like licenses, etc.
- Shortage of important resources.
- Access to raw materials is controlled by existing players.
- Distribution means are controlled by existing players.
- Existing players have secure customer relations. Elevated switching costs for customers.
- Legislation and government acts.

The threat of substitutes:

- Brand dependability of customers.
- Secure customer relationships.
- Switching costs for customers.
- The relative price for performance of substitutes.
- Up-to-date trends.

Competitive rivalry:

- Players are the same size.
- Players have comparable strategies.
- Little or no differentiation between players and their products leading to price competition.
- Low market growth rates.
- Barriers for exit are high.

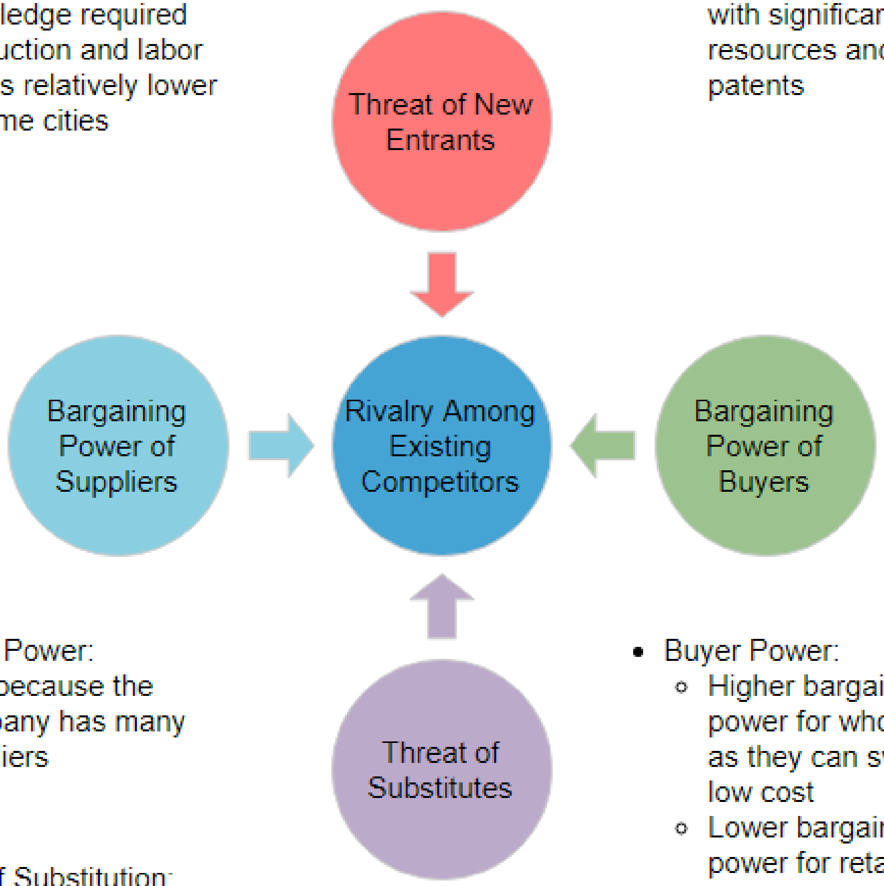
Porter's Five Forces Example - Footwear Company
The bargaining power of suppliers
The bargaining power of customers

wholesale customers
they can switch
at a low cost to the competition
as customers are loyal to the brand.

The threat of new entrants
The threat of substitute
The competitive rivalry

- Threat of New Entrants:
  - Low entry barriers
  - Low R&D expense
  - Not much specialized knowledge required
  - Production and labor cost is relatively lower in some cities

- Competitive Rivalry:
  - High competition
  - A lot of well-established companies with significantly large resources and process patents



- Supplier Power:
  - Low because the company has many suppliers

- Threat of Substitution:
  - Low threat due to high brand loyalty

- Buyer Power:
  - Higher bargaining power for wholesalers as they can switch with low cost
  - Lower bargaining power for retail customers as they are loyal to the brand

The effect on Internet on Porter's 5 forces model

- **The entry of new competitors**
- Digital business changes the rules by lowering the traditional barriers to entry. A digitally based business model requires far less capital and can bring large economies of scale for example

The threat of substitutes

The threat of substitutes is high in many industries since switching costs are low and buyer propensity to substitute is high. In the taxi services example, customers can easily switch from traditional models to the new model simply by installing an app on their smartphone. Propensity to switch from the traditional model is high due to consumer wait times for taxis, lack of visibility into taxi location and so on.

The bargaining power of buyers

Customers and consumers have amassed far more bargaining power today due to instant access to information, insights from social media including access to reviews and feedback, low switching costs via digital channels, price sensitivity, access to substitute products and services with greater ease of use and convenience, as well as increased industry competitiveness as a result of the other forces.

The bargaining power of suppliers

Suppliers can accelerate or slow down the adoption of a digitally based business model based upon how it impacts their own situation.

The rivalry among the existing competitors

The rivalry is heating up because entry and exit barriers are going down due to the comparative low-cost of internet business models, and in many cases new entrants do not even need to own physical assets or infrastructure.