PORTER'S FIVE FORCES ANALYSIS OF US TELECOM INDUSTRY:

Porter's 5 Forces analysis deals with factors outside an industry that influence the competition, the forces inside the industry that influence the way in which firms compete, and so the industry's profitability can be determined in Porter's five forces model. A business has to understand the factors related to its industries and markets in order to compete effectively in the marketplace. Porter (1980) defined the forces which drive competition and described how the competitive environment is created by the interaction of five different forces acting on a business. Porter suggested that the intensity of competition is determined by the relative strengths of these forces.

The nature of competition in an industry is strongly affected by suggested five forces. The stronger the power of buyers and suppliers, the stronger the threats of entry and substitution, and the more competition within the industry.

Main Components of Porter's Five Forces Analysis:

The Porter's Five Forces model, as proposed by Porter, identified five forces which would influence an organization's behavior in a competitive market. These include the following:

- The rivalry between existing sellers in the market
- The power of buyer in the market
- The power of the suppliers in the market
- The potential threat of new sellers entering the market
- The threat of substitute products available in the market

Understanding each of these forces gives organizations the necessary steps to formulate the appropriate strategies to be successful in their market. We will examine these concepts as described by Porter's 5 force model and as applied to US telecom industry simultaneously.

Force 1: The Degree of Rivalry

The degree of rivalry is the very important of the five forces in an industry. Rivalry is only one of several forces that determine industry attractiveness. This force is located at the centre of the diagram. It is high in those industries where there is a threat of substitute products and existing power of suppliers and buyers in the market

Now let us understand the effect of degree of revalry in US telecom sector. The effects of this parameter are determined by:

High Exit Barriers: In any industry, if the exit barrier is high it increases the difficulty of any organization to leave the industry sector. So it makes difficult to let the willing company to leave the industry. Mainly due to its specialized equipment, the telecom industry suffers from high exit barriers.

High Fixed Cost: The industry also suffers from high fixed cost which makes the entry barrier also very high for the industry. It is true that in the telecom industry the biggest barrier to entry is access to finance. When financing opportunities are less available, the rate of entry slows.

Very less time to gain advantage by an innovation: Every company in this industrial sector is investing a huge amount in research and development and marketing strategy. That is why we see any offer launched by any company is counter attacked by other companies very soon. This makes the industry rivalry most prominent.

Price wars: The price war is really very fierce in this industry. Price war in telecom industry has commoditized the market that branding has taken a backseat.

Force 2: The Threat of New Entrants

Both potential and existing competitors influence industry profitability. The threat of new entrants is usually based on the market entry barriers.

Now let us understand the effect of threat of new entrants in US telecom sector.

Prior to Mid-nineties, entry into fixed line telecom business was very difficult owing to several factors, Firstly it was a very capital intensive industry, entry into this industry meant that the firms needed access to huge amount of capital mainly to cover the fixed costs to lay and maintain a physical network (exchanges, fiber optic cables etc) to the premises of customers. In addition to that firms needed to get regulatory approval/licenses from the Federal Communications Commission (FCC), which was both costly, and a tedious affair. Hence the companies in this industry mostly tended to monopolies strictly regulated by the government subject to price controls and moderate to heavy taxation. Deregulation and the telecom act of 1996 provided a significant reduction in barriers as the new entrants did not need to own their networks. The technological changes also provided impetus to the significant reduction of barriers; Internet Telephony provided a way for several firms to enter the market and compete with the incumbents without the significant upfront fixed costs. One of the notable entrants into the business is Vonage. This firm began offering its version of IP telephony product since 2003. The entry of new progressively become very easy, in fact it has become so easy that there are companies like RTC Factory claim to provide services that can let firms start their own branded fixed line IP telephony voice business within 6-8 weeks in 10 easy steps.

Force 3: The Threat of Substitutes

The threat that substitute products pose to an industry's profitability depends on the relative price-to-performance ratios of the different types of products or services to which customers can turn to satisfy the same basic need. The threat of substitution is also affected by switching costs that is, the costs in areas such as retraining, retooling and redesigning that are incurred when a customer switches to a different type of product or service.

Now let us discuss this concept for telecom industry. Several substitute products and services have emerged to fixed line telephones as a result of technological breakthroughs. Some of these are more convenient and offer far greater value to the consumer and have diminished the importance of fixed line phones. Substitutes include IP Telephony, Mobile phones, Satellite, Email, and Instant Messaging etc. Among the several substitutes that have emerged, IP telephony has emerged as the biggest threat. Applications like Skype have been extremely popular among younger generation users and are fast emerging as preferred means of communication. Wireless phones are also getting cheaper each year over the last decade; this has provided consumers with more convenience and mobility, to the extent that the younger demographic now considers a fixed line phone redundant.

Force 4: Buyer Power

Buyer power is one of forces that influence the appropriation of the value created by an industry. The most important determinants of buyer power are the size and the concentration of customers. Other factors are the extent to which the buyers are informed and the concentration or differentiation of the competitors.

In the context of US telecom industry we can say that, with increased choice of several technologies and means of communication available and entrance of several new firms buyer power is been increasing. The consumer now has access to several means of communication like email, instant messaging which are diminishing the importance voice services. Residential consumer also benefits with local number portability (A regulation from FCC which mandates the carriers to move the phone number when the customer switches to a different carrier). This feature makes switching costs negligible. The business segment however is prone to significant switching costs as they rely on more customized products which are tailored to their businesses and most times are locked into long-term contracts.

Force 5: Supplier Power

Supplier power is a mirror image of the buyer power. As a result, the analysis of supplier power typically focuses first on the relative size and concentration of suppliers relative to industry participants and second on the degree of differentiation in the inputs supplied. The ability to charge customers different prices in line with differences in the value created for each of those buyers usually indicates that the market is characterized by high supplier power and at the same time by low buyer power.

The Suppliers in this industry are the manufacturers of telephone switching /switch board equipment, fiber optic cables, network equipment, and billing software makers. The prominent names in this industry include Cisco, Alcatel-lucent, Nokia, Nortel, Motorola and Tellabs etcAfter the deregulation of downstream service providers and the technological breakthrough in IP networks, Telecom equipment makers began to ramp up manufacturing in order to meet the huge anticipated demand, however aftermath the dot com bubble, demand did not pan out as expected and led to overcapacity and eventually demise of several firms. The evidence of decline can be gauged from the fact that the telecommunications industry Association (TIA) reported that in 2001, a cumulative decline of $30.5 billion in revenues. With excess capacity and falling demand, the suppliers have do not have the power and clout to negotiate with the telecom behemoths. However with the demand in recent years has started to pick up with fixed line providers deciding to install fiber based networks to provide faster data and video services.