Porter’s five forces Framework

By

Insert Your Name

Presented to

Instructor’s Name, Course

Institution Name, Location

Date Due

**Table of Contents**

[Porter’s Five Forces Framework 3](#_Toc449796176)

[Purpose 3](#_Toc449796177)

[Background 3](#_Toc449796178)

[Porter’s Five Forces Framework 4](#_Toc449796179)

[Diagram 4](#_Toc449796180)

[Components of the Framework 4](#_Toc449796181)

[The Bargaining Power of Buyers 5](#_Toc449796182)

[The Risk of Entry by Potential Competitors 6](#_Toc449796183)

[The Bargaining Power of Suppliers 7](#_Toc449796184)

[The Intensity of Rivalry 7](#_Toc449796185)

[The Threat of Substitutes 8](#_Toc449796186)

[Discussion 9](#_Toc449796187)

[Conclusion 11](#_Toc449796188)

[Bibliography 12](#_Toc449796189)

# Porter’s Five Forces Framework

# Purpose

This report offers a definitive analysis of the Porter’s Five Forces Framework to determine its usefulness upon application in competitive position analysis. It outlines the benefits and challenges of integrating the framework into corporate strategy. The report offers a conclusive discussion of the elements of the framework through diagrammatic presentation and an extensive analysis. It discusses the application of the framework in the assessment and evaluation of the competitive strength and position of an organization.

# Background

The analysis of the competitive strength and position of an organization is critical for the development of an efficient corporate strategy. Prior to the development and implementation of strategy, the consideration of the various aspects that directly or indirectly influence the profitability of a business is critical. Developed by Michael E. Porter in 1979, the Porter’s Five Forces Framework offers a definitive analysis of the competitive forces Michael Porter termed most influential in a business operation. It helps the management and leadership of a business entity with the analysis of the competitive forces in the environment for the identification of the threats and opportunities. It is therefore of great significance. According to Hill and Jones (2010), the framework focuses on the five competitive forces that shape competition in an industry. These forces include the risk of entry into the market or industry by potential competitors, the intensity of the rivalry among well-established organizations/companies within the industry, the bargaining power of the suppliers and buyers, and the closeness of substitutes to the industry’s products. The inclusion of these aspects in the analysis of the competitiveness of a market is critical for the formulation and implementation of efficient strategy (Walder, 2014).

# Porter’s Five Forces Framework

Buyer Power

**Buyer power**

-the number of consumers

-order sizes

-competitors

-switching costs

-substitutes

-pricing

**Supplier Power**

-number and size of suppliers

-services offers

-ability to substitute

-switching costs

Threat of Substitute

-Substitute performance

-Switching costs

The Threat of New Entry

## Diagram

**Competitive Rivalry**

-Exit barriers

-Industry growth

-Brand identity

-Diversity of competitors

-Corporate stakes

-Switching costs

-Product differences

**The threat of New Entry**

-Time/cost of entry

-Barriers to entry

-Economies of scale

-Absolute cost advantages

-government regulation

-capital input requirement

-switching costs

# Components of the Framework

The Porter’s Five Forces Framework comprises of fives competitive factors that should be considered in the analysis of the competitiveness of a market. It is critical that the management and leadership of an organization considers these forces before the development of strategy to ensure its effectiveness. According to Porter, the stronger each of the forces is, the higher the inability of the established companies to increase prices and earn greater profits (McGuigan, et al., 2008). As such, in some sense the stronger competitive force is a threat because it depresses profitability. On the other hand, a weak competitive force allows companies to earn greater profits and thus can be viewed as an opportunity. In the analysis of the forces, the management and leadership of the business must consider possible changes in view of changing conditions. The changes create new opportunities or threats and thus their analysis is of great importance before the formulation of the appropriate strategic responses (Hill & Jones, 2010). The discussion of the components of the Porter’s Five Forces Framework offer a clearer understanding of their influence in strategy development.

## The Bargaining Power of Buyers

The bargaining power of buyers is a critical component of the Framework. A company’s buyer is the individual customer who consumes its products, or companies that distribute its products to the end users, mainly wholesalers or retailers. For example, the principal buyers of soap and other FMC goods are supermarket are discount stores and supermarket chains, which resell the products to the end users (Hill & Jones, 2010). The bargaining power of the buyers is their ability to bargain down the prices charged by the company or companies in an industry or to increase the costs of the companies by demanding better quality and services. Powerful buyers squeeze profits off a company or an industry by influencing an increment of the costs or lowering of prices and, therefore, should be viewed as a threat. Moreover, weak buyers possess a weak bargaining position, which makes it possible for the company/companies in the industry to reduce costs and increase profits thus increasing their profitability (Rajasekar & Raee, 2013; Schwarzinger, 2012). In the analysis, the consideration of the various circumstances that show the bargaining power of buyers is important.

According to Hill and Jones (2010), buyers are most powerful when the industry supplying the product/service comprises of small companies but has large and few buyers who purchase in large quantities. The circumstances allow the buyers to dominate the companies and can use their purchasing power to bargain for a reduction in prices. Additionally, if the suppliers depend greatly on the buyers and when the switching costs are low, the buyers have a greater purchasing power. Moreover, the buyers are most powerful if they have the ability to enter the industry and produce and can use the power to force price reduction. An analysis of these circumstances is of significance before formulating strategies (Walder, 2014).

## The Risk of Entry by Potential Competitors

The threat of potential entrants/competitors influences the profitability of an industry significantly. According to McGuigan, et al. (2008) and Walder (2014), the greater the barriers to entry the higher the profitability of the incumbent will be. These barriers stem from various factors such as high capital costs, economies of scale, brand loyalty, access to inputs, brand identity, switching costs, absolute cost advantage, and government policy among others. For instance, high capital costs minimizes the possibility of new entrants and promises higher profitability. The absolute cost advantages and economies of scale provide a significant barrier to entry by competitors (Hill & Jones, 2010). Established companies achieve scale of economies through cost reductions gained through mass-production of standardized output, spreading fixed production costs, acquiring discounts on bulk buying of raw materials, and savings accruing from spreading advertising and marketing costs over large volume outputs (Hill & Jones, 2010). Additionally, the elements of brand loyalty and possible switching costs make it difficult for entrants to profit from certain industries. For example, the hotel industry raises the switching costs by issuing frequent guest giveaways. While this is the case, according to Henry (2011) and Hill and Jones (2010) the framework recognizes that it may cost a significant amount to induce a loyal customer to using a new entrant’s product. This poses a barrier to entry. The other barriers work in a similar way to deter the entrance of competitors thus increasing profits for established businesses (Schwarzinger, 2012).

## The Bargaining Power of Suppliers

Suppliers are the companies/organizations that provide the inputs required in the industry whether services, materials, or labour. The ability of the suppliers to influence an increase in prices or raise costs in the industry determines the bargaining power of the suppliers. Powerful suppliers minimize the profitability of companies in an industry by increasing the costs and, therefore, powerful suppliers are a threat. Alternatively, when the suppliers are weak, the business entities in the industry can demand higher quality inputs and force down input prices (Hill & Jones, 2010; BMJ Group, 2014). The bargaining power of suppliers is influenced by different circumstances/situations. For instance, the existence of few substitutes for the products that the suppliers sell and if such products are vital to the industry gives the suppliers a greater bargaining power. Further, situations where the profitability of the suppliers is not significantly influenced by the purchases made by companies in a certain industry enhance the power of the suppliers (Walder, 2014). Moreover, if the suppliers can produce using their inputs then they have a higher bargaining power and thus threaten the reduction of profitability for companies in the industry. In the personal computer industry, companies are greatly dependent on powerful suppliers such as Intel, the world’s largest supplier of PC microprocessors (Hill & Jones, 2010). The dominance of Intel and other world leaders in the industry influences strategic positioning significantly.

## The Intensity of Rivalry

Established firms in any industry compete for the acquisition of a larger market share and dominance. The number and capability of the competing companies influences the development of the competitive rivalry, which influences profitability significantly. Every firm focuses on the achievement of a competitive advantage over competing organizations. The pursuance of a competitive advantage leads the companies to the implementation of various strategies such as changing prices, enhancing product differentiation, adopting more efficient channels of distribution, and exploiting the relationships existing with the suppliers. The intensity of the rivalry is determined or influenced by various market characteristics such as market growth, the number of players, storage costs, switching costs, exit barriers, and the diversity of barriers among others. The more the number of firms the higher the rivalry as the organizations must compete for the resources and market share. Additionally, high fixed costs, low switching costs, high strategic stakes, and slow market growth increase the rivalry (Henry, 2011; Mathooko & Ogutu, 2015; Hill & Jones, 2010).

## The Threat of Substitutes

According to (Henry, 2011), substitutes are products of other industries that may be used as alternatives for the products of a particular industry. The influence of the substitutes influences the operations of companies in the industry facing the threat. Such a threat exists where the demand of a product is affected negatively by the changing prices of the substitute product(s). The existence of more substitutes gives the consumers more alternatives posing a significant threat to the firms, which cannot raise their prices as a result. The competition from the products outside the industry influences the operations and profitability of the companies in the industry. For example, the pricing of aluminium beverage cans is greatly influenced by that of steel cans, glass bottles, and plastic containers. The various containers pose significant challenge and competition to the aluminium industry despite the fact that they are not rivals in the industry (Hill & Jones, 2010). There is a need for the management and leadership of any organization to assess and evaluate the threat of substitutes before the formulation and implementation of corporate strategy.

**Advantages and Challenges**

The Porter’s Five Forces Framework offers various advantages and challenges when used to inform the formulation of strategy. The framework allows the formulation of effective strategy after the analysis of the industry using the various forces. The forces inform decision-making considering the key concerns about competition and other variables that influence profitability. Its focus on the industry makes it a critical tool and attaches certainty on the efficiency of the strategy developed thereafter (Dobbs, 2014). However, according to Stewart Neill, the framework offers major challenges based on the assumption made in its application during the analysis of the competitiveness of a market and position of a company. According to the academic, the model assumes that the buyers, suppliers, and competitors are separate entities with limited interaction and which never collude or influence each other directly. Additionally, the assumption that the creation of barriers or the structural advantage is the source of value and the assumption that there is always low uncertainty limit the effectiveness of the framework (McGuigan, et al., 2008). Moreover, the application of the framework is only possible under the consideration of the stage in the lifecycle of the business, the changing nature of the market and the industry, the impact of the government, and with the entire industry and not specifically an individual company (Hill & Jones, 2010).

# Discussion

The consideration of the five forces of Michael Porter’s model is critical before the development of strategy for operating in a particular industry. The management must consider different aspects for the various factors to ensure the development of effective strategy. For instance, concerning the threat of new entry, the management should consider how easy it is to start up a new business in the industry, the threat of emerging businesses, the rule and regulations, the capital required to start a business, and the existing barriers to entry, which give the business greater power (Walder, 2014). Further, concerning the buyer and supplier power, the management should consider the number, power, and influence of both parties before formulating the strategy (McGuigan, et al., 2008). The consideration of the aforementioned allows the management to consider each aspect and develop and efficient strategy. Additionally, as Hill and Jones (2010) assert, the consideration of the ease of finding alternative products or services, the possibility of outsourcing or automating the products/services, the level of competition, and the situation of the competitors in line with competitive rivalry and the threat of substitution, both forces of the model.

The application of the Porter’s Five Forces Model allows a critical analysis of the industry and the market. It ensures an effective evaluation of the competitive position of organizations within the industry analyzed. The model allows the management of various companies therein to formulate and implement strategies that consider the factors and forces that influence or may influence their operations and profitability. The model remains an effective industry competitive analysis and offers the essential information and knowledge for the development of efficient strategy (Magretta, 2012). The implementation of strategy informed by the analysis of the market and the industry using the framework plays a critical role in the enhancement of an organization’s ability to achieve a competitive edge over the competitors. Additionally, such a strategy allows the management to adopt measures that prepare the organization to deal with uncertainties arising from new entrants, the influence of suppliers and buyers, and the new competitors. In view of all the above mentioned, the importance of the framework is undeniable (Walder, 2014).

# Conclusion

The Porter’s Five Forces Framework is a critical analytical tool for the assessment and evaluation of a competitive environment. It plays a significant role in enabling the management and leadership of any organization to acquire critical knowledge for the development of efficient strategy. The application of the Framework allows the determination of the attractiveness or the profit potential of an industry through an examination of the interaction of the various competitive forces. After the analysis of the interaction of the five competitive forces, the management considers their strength in the determination of the (possible) returns on investment or profitability within the particular industry. The different forces include the threat of new entrants, the bargaining power of suppliers and the bargaining power of buyers, the threat of substitutes (alternative products or services), and the intensity of the competitive rivalry. Moreover, the management assesses the ability of the organization to compete effectively after the analysis. The Framework offers various benefits such as information and knowledge concerning the industry, which is significant for effective strategy development. It is a rigorous approach for the analysis of the competitive position of companies in relation to the industry. As such, its application ensures informed decision-making and strategy development, minimizes risks, and enhances effectiveness in the management of resources.

# Bibliography

BMJ Group, 2014. Assessing the industry using Porter's five forces. *The Veterinary Record,* 174(1), pp. 3-4.

Dobbs, M. E., 2014. Guidelines for applying Porter's five forces framework: a set of industry analysis templates. *Competitiveness Review,* 24(1), pp. 32-45.

Henry, A., 2011. *Understanding strategic management.* 2nd Edition ed. Oxford: Oxford University Press.

Hill, C. W. L. & Jones, G. R., 2010. *Strategic management theory : an integrated approach.* 9th Edition ed. Boston, MA: Houghton Mifflin.

Magretta, J., 2012. *Understanding Michael Porter : the essential guide to competition and strategy.* Boston: Harvard Business Review Press.

Mathooko, F. & Ogutu, M., 2015. Porter's Five Competitive Forces Framework and other Factors that Influence the Choice of Response Strategies Adopted by Public Universities in Kenya. *International Journal of Educational Management,* 29(3), pp. 334-354.

McGuigan, J. R., Moyer, R. C. & Harris, F. H. d., 2008. *Managerial economics : applications, strategy, and tactics.* Mason, Ohio: Thomson/South-Western.

Rajasekar, J. & Raee, M., 2013. An analysis of the telecommunication industry in the Sultanate of Oman using Michael Porter's competitive strategy model. *Competitiveness Review,* 23(3), pp. 234-259.

Schwarzinger, A., 2012. *Porter's Five Forces Framework - An Analysis of the Swiss TV-Broadcasting Industry: Seminararbeit der Veranstaltung "Business Policy and Strategy" an der Universität Zürich.* Berlin: GRIN Verlag.

Walder, J., 2014. *A critical evaluation of Michael Porter’s five forces framework.* New York: GRIN Verlag.