

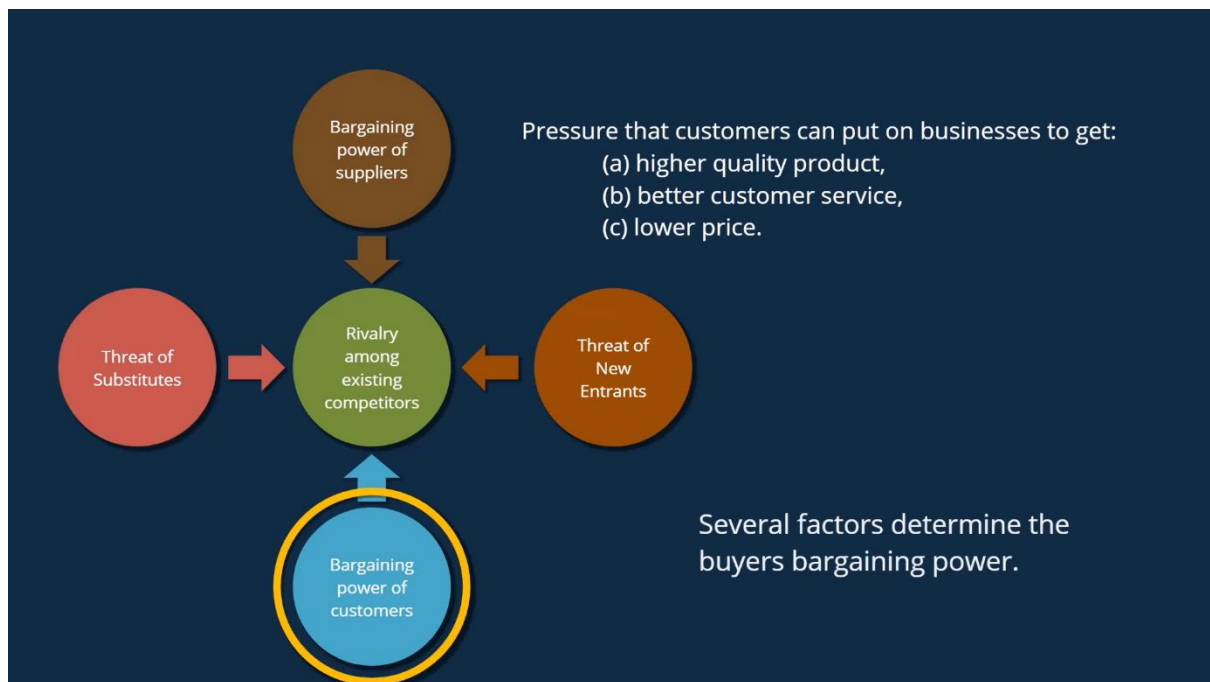
# M5L4. Porter's Vertical Forces

## Slide #1



In this topic, the professor describes porter's vertical forces bargaining, power of buyers and bargaining power of suppliers.

## Slide #2



Bargaining power of buyers.

Buyers bargaining power refers to the pressure customers can put on businesses to get them to provide higher quality products, better customer service, and lower price.

According to the five force analysis framework, buyer's power is one of the forces. that shape the competitive structure of an industry.

Several factors determine the buyer's bargaining power.

### Slide #3



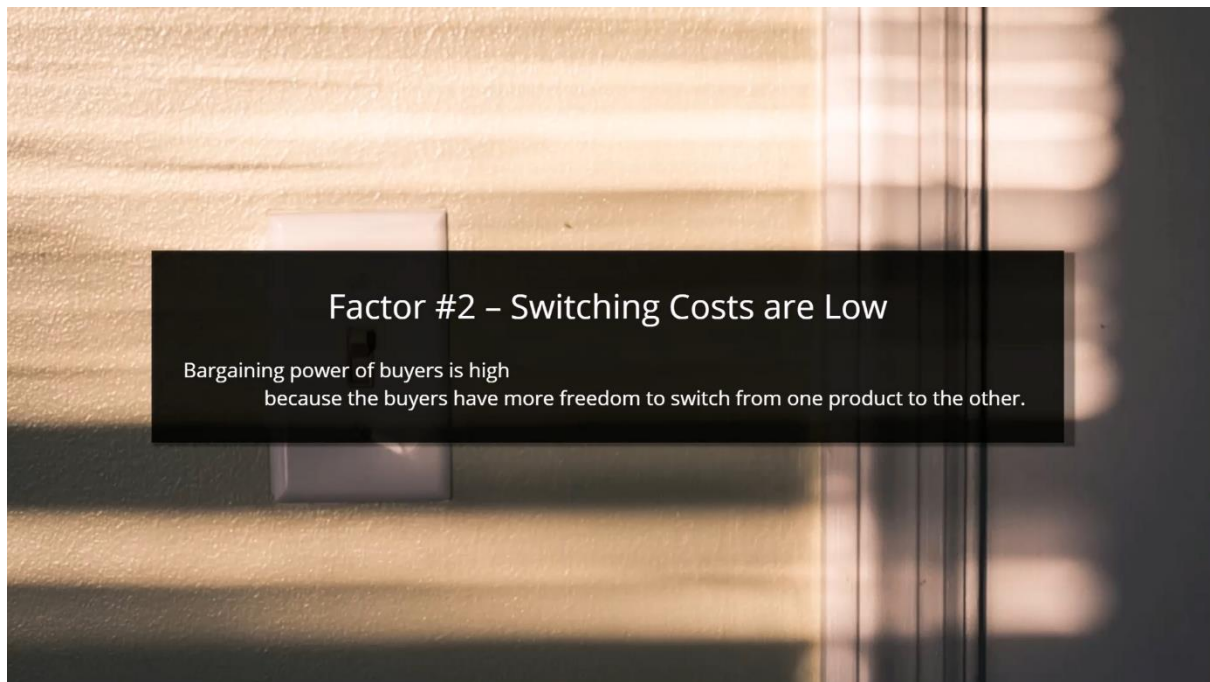
First, obviously, large volume buyers are a particularly strong force in the industry that requires high fixed costs.

The long-term large volume orders raise the stake to keep the production capacity filled.

Some examples of the large volume purchase are refining and bulk chemical industries.

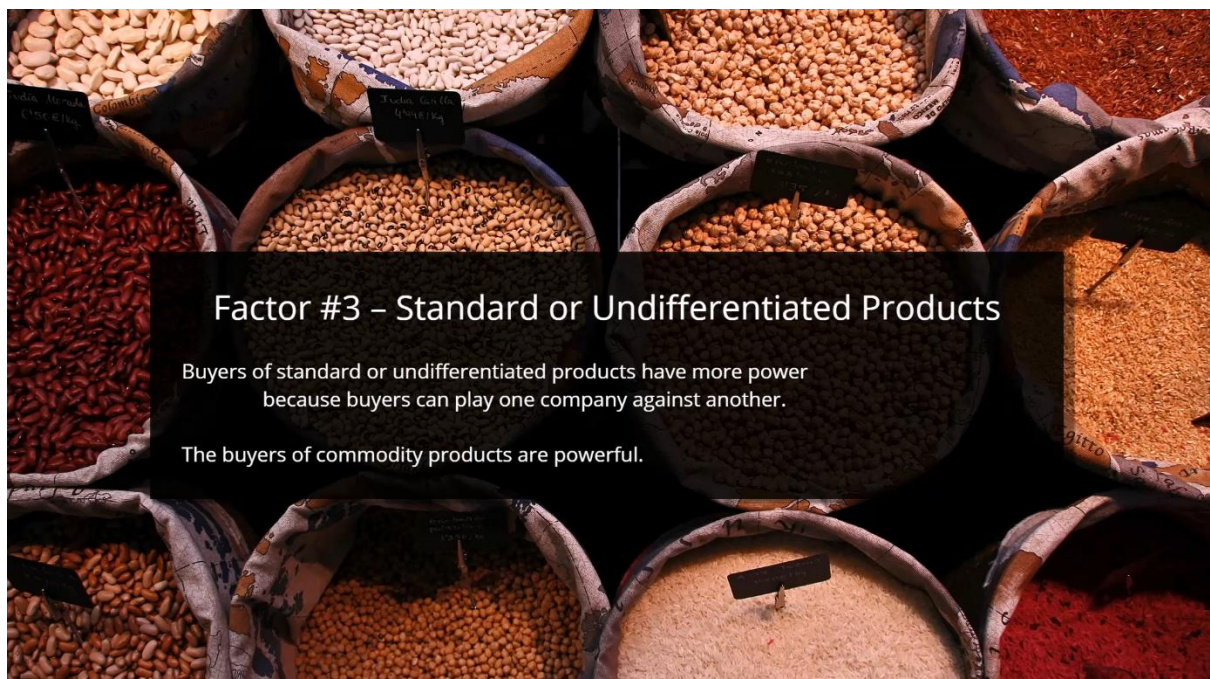
The buyers of bulk chemical is very powerful in the industry.

#### Slide #4



The second, if switching costs are low, the bargaining power of buyers is high, because the buyers have more freedom to switch from one product to the other.

#### Slide #5



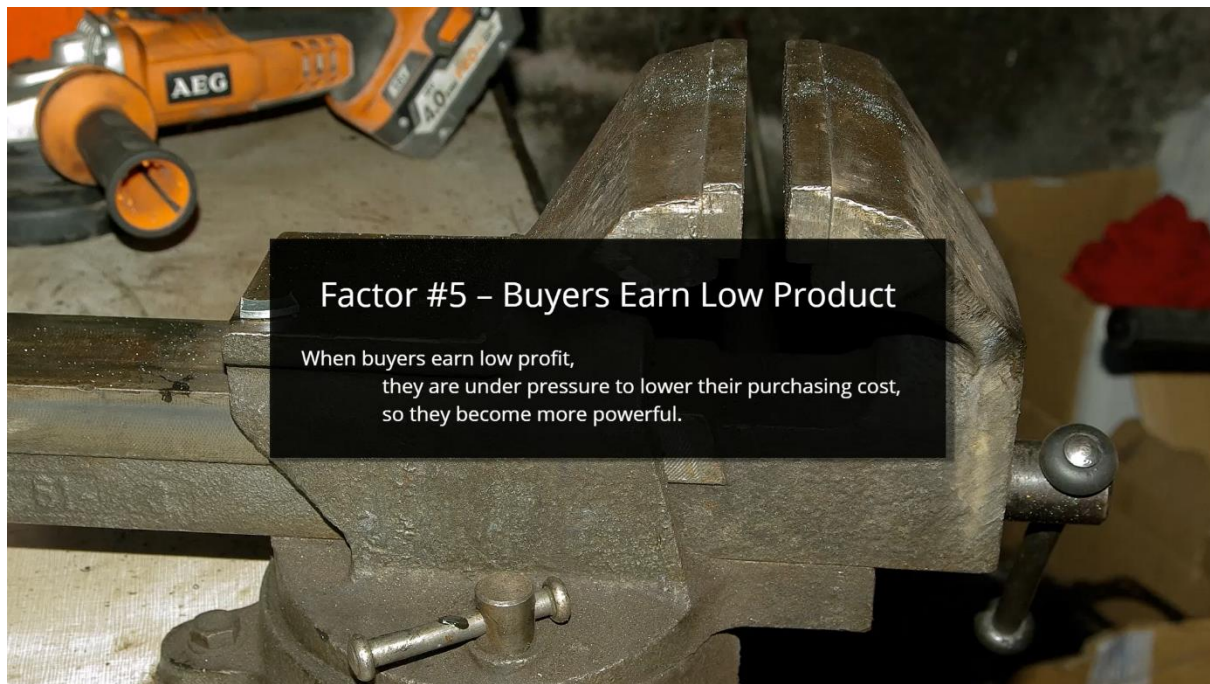


The buyers of commodity products are powerful.

Buyers will try very hard to get a competitive price of their products, they are powerful in that regard.

The buyers will try very hard to get a competitive price of their products, and they are powerful in that regard.

**Slide #7**



The fifth factor is that when buyers earn low profit, they are under pressure to lower their purchasing cost, so they become more powerful.

## Slide #8

### Factor #6 – Effect of Quality

When the quality of buyers' product is very much affected by the industry's product, buyers are generally less price sensitive.

#### Example #1: Oil/Gas

Oil field operators may be less sensitive to the price of critical equipment because malfunction leads to large losses.

#### Example #2: Healthcare Industry

Medical instrument manufacturers are less price sensitive to the enclosure type of equipment because quality of enclosure can influence users' impression about quality of equipment inside, those medical device manufacturers want to pay for enclosures of high quality.



Sixth, when the quality of buyer's product is very much affected by the industry's product, buyers are generally less price sensitive.

For example, the oil field operators may be less sensitive to the price of critical equipment because the malfunction of those equipment leads to large losses.

The other example is in the healthcare industry.

The medical instrument manufacturers are less price sensitive to the enclosure type of equipment because the quality of enclosure can influence the user's impression about the quality of equipment inside.

And those medical device manufacturers want to pay for the enclosures of high quality.

## Slide #9



### Factor #7 – Backward Integration

When the buyers of a product have the capability to backward integrate the parts, the buyers of those parts have more bargaining power.

For example,  
in auto industry, those major automakers always threat to make the parts themselves when negotiating with part suppliers about price and quality of parts.

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**Slide #10**



In summary, the buyers of a product can be more powerful than the sellers of the product if buyers have more options and sellers have less options.

## Slide #11



Suppliers can also exert bargaining power.

By raising prices or reducing the quality of products, powerful suppliers can squeeze profit out of an industry.

## Slide #12

### Factor #1 – Few Suppliers

A supplier group is powerful if the market is dominated by a few companies, and if suppliers' industry is more concentrated than the industry that purchases the product from the suppliers.



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For example, the airplane industry, there's only two companies, Boeing and Airbus.

They dominate the whole aircraft industry, and there are more buyers.

All the major airlines purchase airplanes from one of those two companies.

So the suppliers of airplanes are very powerful.

## Slide #13

### Factor #2 – Unique or Differentiated Supplier Product

If a suppliers' product is unique, or at least differentiated, its customers will incur significant switching cost as result of changing their product.

Powerful suppliers strategically build up switching cost to strengthen its competitive advantage.

Examples: (a) engineering software providers,  
(b) accounting software providers,  
(c) critical equipment providers.



The second is, if a supplier's product is unique, or at least differentiated, its customers will incur significant switching costs as a result of changing their product.

Powerful suppliers strategically build up switching costs to strengthen its competitive advantage.

Some examples are the engineering software providers, the accounting software providers, and some critical equipment providers.



## Slide #14

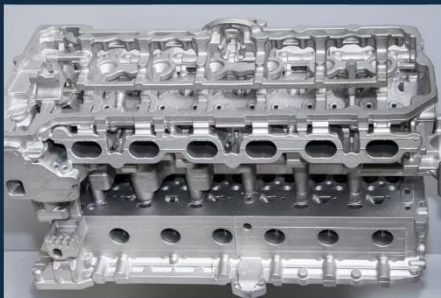
### Factor #3 – Competing Substitute

The competing substitute product lowers the power of suppliers.

For example:

In recent years many automakers follow Ford's move to increase the use of aluminum in vehicles.

The competition between steel companies and aluminum companies checks the power of each supplier.



The third factor affecting suppliers' power is the competing subsidy.

The competing subsidy products lower the power of suppliers.

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## Slide #15

### Factor #4 – Forward Integration

Suppliers also can threat to forward integrate an industry's product.



The fourth factor, suppliers also can threat to forward integrate an industry's product.

This kind of forward integration happened a lot in the Semiconductor and recently smartphone industries, the part suppliers learned how to design the cell phone, how to design a semiconductor chip, and they make the cell phone product and the chip themselves.

Samsung used to be a supplier of Apple's iPhone parts, the battery and also the screen and Samsung quickly learned how to make cell phones and then to introduce new cell phones to compete with Apple.