Assignment

Write critical review on competitive forces shape strategy

Program

MBA (Non Business)

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A summary of Michael Porter’s “The Five Competitive Forces That Shape Strategy”

from "The Five Competitive Forces That Shape Strategy" by Michael E. Porter, *Harvard Business Review*, January 2008

In general, competition has been looked at too narrowly by managers. There is a broad set of competitors that need to be looked at, which are described in “Five Competitive Forces that Shape Strategy” by Michael Porter. If these forces are too intense in an industry, it is very hard for a company to earn a return on investment. When the forces are benign, many if not all, companies are profitable. When some forces are stronger than others, those forces determine the profitability of the industry and are the most important to look at when you are forming a strategy. Industry structure sets profitability in the long run and provides a framework for anticipating and influencing competition and profitability over time. The five competitive forces are threat of entrants, power of suppliers, power of buyers, threat of substitute products or services, and rivalry among existing competitors.

First we have the threat of new entrants into the industry. New entrants bring new capacity and a desire to gain market share. This puts pressure on prices, costs, and the rate of investment necessary to compete in the industry. When the threat of new entrants is high, existing companies must hold down their prices or boost investment to deter new entrants. Something to be noted about this force is that it is not the physical entry of new competitors into the industry that drives profitability down, it is the threat of new entrants.

The power of suppliers in an industry is the second force that shapes strategy. Powerful suppliers can capture more value by themselves by charging higher prices, limiting the quality of services, or shifting costs to industry participants. There are a few different things that give suppliers this power. A supplier is powerful if: it is more concentrated than the industry it sells to, the supplier groups does not depend heavily on the industry for its revenues, industry participants face switching costs in changing suppliers, suppliers offer products that are differentiated, there is no substitute for hat the supplier group provides, or if the supplier group can credibly threaten to integrate into the industry.

The power of buyers is the third force. Powerful customers can capture more value by forcing down prices, demanding better quality or more service, and playing industry participants against each other. These sorts of actions will reduce industry profitability. Buyers

are especially powerful if they have negotiating power in the industry. Buyers have negotiating power if: there are few buyers, the industry's products are standardized or undifferentiated, and buyers face few switching costs in changing vendors.

The fourth force is the threat of substitutes. A substitute performs the same or a similar function as an industry's product by a different means. Sometimes the threat of a substitute is indirect. An example if this would be a movie theatre and an arcade competing for teenagers that are looking for entertainment. The threat of a substitute is high if: it offers an attractive trade off to the industry's product, the buyer's cost of switching to the substitute is low, or if firms cannot read each other well because of various reasons.

The fifth force is the rivalry among competitors. This is dependent on the intensity and then the basis on which they compete. Rivalry is most destructive to profitability to if it gravitates solely towards price. Price competition transfers directly from the industry to its customers and gives them the most benefit. When competitors aim to meet the same customer needs or to compete on the same attributes, this leafs to zero-sum competition. The opposite of this is positive-sum competition which happens when companies compete on different attributes, service, customer support, etc.

This framework should ideally be applied at all levels of the organization. This is sometimes difficult with mid or low level managers. A way to combat this is to make it intuitive in the company and should be emphasized in day to day activities. The number one purpose of formulating a strategy is company alignment; everyone should be informed of the strategy. By considering all five forces, a strategist keeps overall structure in minds instead of gravitating towards any one specific element. Industry analysis is important and should look at the structural underpinnings of profitability. They should also differentiate temporary and cyclical changes from structural changes. A risky strategy would be eliminating rivals completely. This will raise profit and will attract new competitors into the industry.

The most important lesson that I've taken away from this assignment is to look at all of the five forces concurrently when conducting an industry analysis. When a strategist loses sight of the big picture, they are more likely to let things slip through the cracks. I've also learned that differentiating your product or service based on customer service can put you ahead of the competition in most industries.