Porter’s “5 forces” model

Porter Competitive Model
(Identify the Industry and the Specific Market Being Evaluated)

- Potential New Entrants
- Bargaining Power of Suppliers
- Intra-Industry Rivalry
- Strategic Business Unit
- Bargaining Power of Buyers
- Substitute Products and Services

Example: Usefulness of Porter Model
Bob wants to start a dentist office
- However, Bob did not go to dental school
- Bob will hire the dentist and other staff
- Is this a good model?

Suppose Alice, who is a dentist, opens an office
- New Entrants
- School graduates
- Dentists moving in from other regions
- Intra-industry rivals
- Other local dentist offices

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Porter Competitive Model?
- What is it?
  - A model to help understand the competitive environment in which a company operates.

- What are the “5 forces”?
  - Intra-Industry Competition
  - Bargaining power of Suppliers
  - Bargaining power of Customers
  - Substitutes
  - Threat of New Entrants.

Education Industry - Universities
- Potential New Entrants
  - Foreign Universities
  - Skill in Strategy by Universities or Companies

- Bargaining Power of Suppliers
  - Faculty
  - Skill
  - Equipment and Service Suppliers
  - Alumni
  - Foundations
  - Governments
  - IT Vendors

- Intra-Industry Rivalry
  - SBU: UCSC
  - Rivals: UC campuses, CSU, Private universities, Community Colleges

- Bargaining Power of Buyers
  - Students
  - Parents
  - Businesses
  - Employers
  - Legislators

- Substitute Products and Services
  - Internet Distance Learning
  - Books and Videotapes
  - Computer-Based Training
  - Company Education Programs

- Threat of New Entrants
  - Students
  - Parents
  - Businesses
  - Employers
  - Legislators

Suppose Alice, who is a dentist, opens an office
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- Substitute Products and Services
  - Alternative Medicine?
Threat of New Entrants
- Barriers to entry
  - Supply-Side Economies of Scale
  - Demand-Side Benefits of Scale
    - (Network Effects)
  - Customer Switching Costs
  - Capital Requirements

Threat of New Entrants
- Barriers to entry (Cont’d)
  - “Incumbency Advantages”
    - Prop. Technology, brand, preemption of best locations etc.
  - Unequal Access to Distribution Channels
  - Government Policy
  - Expected Retaliation

Power of Suppliers
Increases if...
- Suppliers more concentrated than industry sold to.
  - Ex: Microsoft → PC suppliers
- Suppliers do not depend heavily on industry
- Industry participants face switching cost
  - Bloomberg terminals

Power of Suppliers
Increases if (cont’d)...
- Suppliers offer differentiated products
  - Distinctive drugs
- No substitute
  - Pilots
- Suppliers threaten to integrate forward

The Power of Buyers
Increases if...
- Buyers concentrated
- Industry products standardized or undifferentiated
- Low switching costs in changing vendors
- Buyers threaten to integrate backward
  - Soft drink companies making containers

The Power of Buyers
Increases If... (Cont’d)
- Product is large part of buyer budget
- Buyer group earns low profits
- Quality of buyer’s product not affected by industry prod.
  - Counter ex: production quality cameras
- Product has little effect on buyer costs
Power of Buyers Continued...

- Intermediate Customers (assemblers or distribution channels)
  - Gain bargaining power by influencing downstream customers (example: retailers)
- Counter Strategy:
  - Make end-customer aware of component
    - Bike parts
    - "Intel inside"
    - And others

Threat of Substitutes

Threat INCREASES if...
- Substitute offers attractive price-performance
  - Internet phone service vs. long distance
  - Netflix vs. Blockbuster
- Buyers switching cost low
  - Generic vs. name-brand drugs

Intra-Industry Rivalry

Intensity INCREASES if...
- Competitors numerous or roughly same size
- Industry growth slow
- Exit barriers are high
  - Companies have highly specialized assets

Price competition

- Especially bad for profitability
- Likely if...
  - Products of rivals are identical
  - Fixed costs are high, marginal costs low
  - Capacity must be added in large increments
  - Product perishable
    - Airline seats, hotel rooms
  - Competition on dimensions other than price can increase industry profitability

Factors that may influence all forces

- High Growth Rate
  - Not necessarily means high profits
- Technology and Innovation
  - Not necessarily more profitable than mundane industries

Factors that may influence all forces (cont’d)

- Government
  - Goes both ways
    - Eg: patents increase entry barriers
    - Labor policy may strengthen suppliers
- Complementors
  - Can raise switching costs (video game consoles)
  - Or lower barriers to entry (software using Windows API)
Industry structure Changes

- Threat of entry changes
  - Patent expires
    - 3 companies enter market day Merck’s Zocor patent expires
  - Strategic Decisions change
    - Big box retailers invest in supply chain management, point of sale tracking, etc.
    - Increases economies of scale and raises entry barriers
  - Travel agents and airlines

Strategy Implications

- Build defenses or find industry niche that competitive forces weakest
  - Example: Paccar heavy trucks

Strategy Implications (Cont’d)

- Example: Music Industry
  - Internet distribution has not changed that a handful of “labels” dominate
- Example: Apple
  - Labels did not want to sell on each other’s platforms...
  - Apple exploited this

Strategy Implications, cont’d

- Strategies to Shape industry structure
  - Standardize parts from suppliers to encourage supplier competition
  - Expand services in a way that increases customer switching costs

Strategy Implications, cont’d

- Example: Sysco
  - Emphasized value added services: Menu planning, inventory management, credit
    - Shift competition away from price
- Example: IBM
  - PC
    - Push critical components to suppliers: MS, Intel
    - Standardized role of PC maker

Strategy Implications, cont’d

Strategies to Shape Industry Structure

- Work around powerful distribution channels
- Raise R&D to scare off new entrants
- Compete with rivals on dimensions other than price.
Defining the industry

- Boundaries of industry
  - Scope of products
  - Geography
  - Is competition regional or global?

- Do different products share similar buyers, suppliers, etc...
  - If so, they can be thought of as same industry
  - Example: Car oil vs. Truck and stationary engine oil
  - Different buyers, supply chain etc.
  - Different industries!