



The Five Competitive Forces That Shape Strategy: Michael Porter
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OVERVIEW

In order for a business to sustain long-term profitability in a competitive marketplace, strategy must take into account the competitive realities of the industry. While no ambitious leader would want his/her strategy and vision dictated by competitors, a successful strategy will anticipate and mitigate the competitive landscape. The extended rivalry that results from all five forces defines an industry's structure and shapes the nature of competitive interaction within an industry.

Most successful businesses keep tabs on established rivals, but there are 4 additional competitive forces that can impact strategy. Michael Porter describes these forces in an article entitled; "The Five Competitive Forces That Shape Strategy". Awareness of the five forces can help a company understand the structure of its industry and stake out a position that is more profitable and less vulnerable to attack. For example, a leader can develop strategies to;

- Position the company where the competitive forces are weakest
- Exploit changes in the forces
- Reshape the forces to compliment the strategy

Using Michel Porter's Five Competitive Forces model will help you to analyze the key forces in an industry in order to identify the "Opportunities" and "Threats" facing your business. This disciplined thinking exercise enables you to create a robust SWOT analysis.

#1. Competitive Rivalry

If you have many competitors offering equally attractive products and services, then you'll most likely have little power in the industry. If suppliers and buyers don't satisfy their needs by doing business with you, they can simply go elsewhere. On the other hand, if you are meaningfully different from your competition, and can sustain that advantage, then you may have more power.

Read the Michael Porter article entitled, *"The Five Competitive Forces That Shape Strategy"*.

Consider the following factors and then answer the four questions on the next page;

- What is the Industry growth rate?
- Industry life cycle? (Introduction / Growth / Maturity / Decline)
- How profitable is the industry?
- Are the cost of supplies increasing or decreasing? Why?
- What levels of capital utilization are required for success in the industry – is it critical to invest in complex infrastructure or heavy machinery?
- How fast is technology changing in the industry? Will you be able to keep up?
- Number of competitors
 - Is the industry dominated by a few large companies, or is it fragmented with many small businesses?
 - Is there enough room for everyone?
 - Are you gaining or losing share?
- Are the products / services very similar, or highly differentiated within the industry?
- Is skilled labor readily available?
- How strong is your brand identity in the industry?
- Commoditization – how price competitive will the industry become in the future?
- Who will have sustainable competitive advantages?
- Who will have economies of scale = production in large quantities with lower costs?
- Who will have cost advantages – outsourcing, etc?
- Who will have promotional spending advantages?
- Will any competitors engage in predatory pricing / product dumping / loss leaders?
- Industry exit barriers – how costly would it be to close down?

1. What is the level of competitive rivalry in today's environment (circle one)?
Low / Medium / High

What are your top 3 reasons for the response you gave?

2. What will be the level of competitive rivalry in 3-5 years (circle one)?
Low / Medium / High

What are your top 3 reasons for the response you gave?

3. What moves are your key competitors likely to make in the next 3-5 years?

4. What strategic moves do you need to make in the next 3-5 years?

#2. Threat of New Entrants

Your power is also affected by the ability of new competitors to enter your market. If it costs little in time, money or skill to enter your market, if there are few economies of scale, or if you have little protection for your key technologies, then new competitors can quickly enter your market weakening your position.

However, strong and durable barriers to entry can provide you with some protection if you have the ability to take advantage of it. Consider the following factors and then answer the three questions below;

- Capital and Learning requirements
- Access to suppliers
- Economies of scale
- Cost for customers to switch to new entrants
- New entrants ability to access distribution channels
- Customer loyalty and brand equity of the existing players
- Expected retaliation by existing players
- Government protection regarding competition

1. What is the threat of New Entrants in today's environment (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

2. What will the threat of New Entrants be in 3-5 years (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

3. What strategic moves do you need to make in the next 3-5 years to counter this threat?

#3. Threat of Substitutes

Your competitive power is affected by the ability of your customers to find a different way of achieving the similar solution or outcome. In some cases, this is driven by new technology. For example, digital music downloads were a substitute for buying CD's. If substitution is easy and substitution is viable, then this weakens your power.

Consider the following factors and answer the four questions below;

- Availability of substitute products / services
- Relative performance of substitutes
- Perceived differentiation in customer's mind
- Customer switching costs
- Technology changes
- Structural changes that could render your model obsolete

1. What is the threat of substitution in today's environment (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

2. What will the threat of substitutes be in 3-5 years (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

3. What substitute offerings could impact your industry over the next 3-5 years?

4. What strategic moves do you need to make in the next 3-5 years to counter this threat?

#4. Bargaining Power of Suppliers

How easy is it for suppliers to drive up prices? This is determined by a number of factors including the number of suppliers, uniqueness of their offering, and the cost of switching from one supplier to another. The fewer the supplier choices you have, and the more you need their help, the more powerful your suppliers are.

Consider the following factors and answer the four questions below;

- Number of suppliers
- Availability of substitute sources of supplies
- Ability for you to easily switch suppliers
- Supplier price setting power
- Size of your purchases relative to other buyers
- Supplier ability to favour other buyers
- What is the threat of forward integration (supplier becomes a direct competitor)?

1. What is the bargaining power of suppliers in today's environment (circle one)?
Low / Medium / High

What are your top 3 reasons for the response you gave?

2. What will the bargaining power of suppliers be in 3-5 years (circle one)?
Low / Medium / High

What are your top 3 reasons for the response you gave?

3. What moves are your suppliers likely to make in the next 3-5 years?

4. What moves do you need to make in the next 3-5 years?

#5. Bargaining Power of Customers

How easy it is for buyers to drive your prices down? This is determined by many factors including the number of buyers, the importance of each individual buyer to your business, and the cost to them of switching from your offering to those of your competitors. If you deal with a few, powerful buyers, they are often able to dictate terms to you.

Consider the following factors and answer the four questions below;

- # of customers – are there a few large buyers controlling a large portion of the market?
- Customer price setting power
- Customer perception of differentiation between you and your competitors
- Cost of them switching to your competitors or substitutes
- Size of their purchase relative to other customers
- What is the threat of backward integration (customer decides to do what you do for themselves)?

1. What is the bargaining power of customers in today's environment (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

2. What will the bargaining power of customers be in 3-5 years (circle one)?

Low / Medium / High

What are your top 3 reasons for the response you gave?

3. What moves are your customers likely to make in the next 3-5 years?

4. What strategic moves do you need to make in the next 3-5 years?