five forces

characteristics

author:	Porter, Michael E.
country:	United States
period:	1980
type:	theory
role:	consultant
activity:	analyse
topic:	strategic management
abstr. level:	environment
perspective:	living
status:	final
module:	classics I
comments:	0

related models

dynamic competitive forces

description:

Michael Porter's innovative research in the 1980's changed managers' perceptions of their own industry's importance as a factor for their company's strategy. Business unit managers would now have to study their industry's characteristics since an industry's structure determines its relative economic attractiveness and hence, the profit potential of all companies within that particular industry.

Prior to Porter's publication, economists studying Industrial Organisation explained varying levels of profitability between industries on their structural differences. Porter focused on private policy rather than on public policy, that is, how to maximize profits instead of how to locate excess profits. Industry as a factor changed almost overnight from a given to an important variable in a firm's strategic decision-making process. Porter made it clear that choosing a firm's relative competitive position within a selected industry is a decision of secondary importance.

Porter's framework consists of five fundamental competitive forces:

1. *Entry of competitors*
assessing the ability of new entrants to start operations and the structural barriers they must overcome;

2. *Threat of substitutes*
assessing the ability of new products with superior characteristics to replace existing product(s) or service(s);

3. *Bargaining power of buyers*
assessing the relative strength and number of buyers;*

4. *Bargaining power of suppliers*
assessing the relative strength and number of sellers;*

5. *Rivalry among the existing players*
assessing the relative competitive strength of rival firms.*

* Concentration ratio (CR): the percent of market share held by the four largest firms within an industry is frequently used as a leading measure. A high CR means that few firms hold a large market share, are less competitive, and create a less competitive, more monopolistic landscape. Less competition leads to higher profit margins. A low concentration ratio indicates that an industry is characterized by many rivals, none of which has a significant market share. These fragmented markets are said to be competitive.

assets:

Five Forces
ProvenModels • editor PM • version 0.4 • 157 KB

Five Forces attributes and quick scan
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five forces dynamics
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pros:

- The model helps to understand how value is shared among actors, and provides insight into redistribution of profits.
- The model takes a broader view on competition than only a firm's existing competing firms.
- The business unit level provides a context beyond a single product or range of products.
- Porter's model emphasises an outside analysis of the organisation's environment over an internal focus.

cons:

- The model assumes a given state of affairs, and does not apply well to industries in (contant) turmoil.
- The analysis is reactive and does not include other perspectives such as the resource based view in which organisations can reshape an industry based on existing core competences and intrinsic will power.
- The analysis is based on the assumption that firms strive only for a competitive advantage over their rivals and exclude other motivations.
- Buyers, suppliers and (new) competitors are assumed unrelated and do not operate in networks outside of the industry under observation.
- Many industry lines are blurred. The creation of transient over contant competitive advantages uses

- Many industry lines are blurred. The creation of transient over contant competitive advantages uses arenas rather than industries as an object of study. Arenas combine a customer segment, an offer and a delivery mode to generate a meaningful context for launching strategic initiatives.

references:

- Competitive Strategy: Techniques for Analyzing Industries and Competitors
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