The 5 competitive Forces of Michael Porter

Definition

- Five forces can help a company understand the structure ot its industry and stake out a position that is more profitable and less vulnerable to attack
- The extend rivalry that results from all five forces defines an industry's structure and shapes the nature of competitive interaction within an industry
- Industry structure drives competition and profitability
- Competitive forces sets industry profitability in the medium and long run
- Competitive forces reveals the roots of an industry's current profitability while providing a framework for anticipating and influencing competition and profitability over time
- Understanding industry structure is also essential to effective strategic positioning
- Defending against competitive forces and shaping them in a company's favor are crucial to strategy
- The strongest forces determine the profitability of an industry and become the most important to strategy formulation
- Determines the industry's long-run profit potential because it determines how the economic value created by the industry is divided
- How much is retained by companies in the industry versus bargained away by customers and suppliers, limited by substitutes, or constrained by potential new entrants
- Considering five forces, a strategist keeps overall structure in mind instead of gravitating to any one element

. A strategist remains focused on structural conditions rather than on gleeting factors

	THREAT OF ENTRY	POWER OF SUPPLIERS	POWER OF BUYERS	THREAT OF SUBSTITUTES	RIVALRY AMONG EXISTING COMPETITORS		FACTORS
WHAT?	New entrants to an industry - start-ups, foreign companies or companies in related industries - bring new capacity and desire to gain market share	Powerful suppliers capture more of the value for themselves by charging higher prices, limiting quality or services, or shifting costs to industry participants.	Powerful customers can capture more valyue by forcing down prices, demanding better quality or more service (threby driving up costs), and generally playing industry participants off against one another, all at the expense of industry profitability	A substitute performs the same of a similar function as an industry's product by a different means. The threat of substitution is downstream or indirect, when a substitute replaces a buyer industry's product.	High rivalry drives down an industry's profit potential depends, first, on the intensity with which companies compete and, second, on the basis on which they compete. The strength of rivalry reflects not just the intensity of competition but also the basis of competition. The dimensions on which competition takes place, and whether rivals converge to compete on the same dimensions, have a major influence on profitability		Factors are neither inherently good nor bad for industry profitability. The best way to understand the influence of factors on competition is to analize how factors affect the fice competitive forces
	Examples	Examples	Examples	Examples	Examples		Examples
HOW?	- Pressure on prices - Pressure on costs - Pressure on rate on Investment - Leverage capabilities - Leverage cash flows - Pepsi going water industry - Microsoft going internet browsers - Apple going music distribution	- Squeeze Profitability - Raising prices of materials - Limiting quality - Limiting Services - Shifting costs to industry participants - Microsoft raising price of its near monopoly on Operating Systems	- Pressure price reduction - Demanding better quality - Demanding better service - Driving up costs - Playing industry participants aga - Squeeze Profitability - Telecommunication equipments - Offshore drilling - Bulk chemicals	- Profitability suffers - Place ceiling on prices - Reduce bonanza an industry can reap - Videoconferencing substitute of travel - Plastic substitute of aluminium - Email substitute of express mail - Cellphone substitute of wired telephone			
FORCES	BARRIERS OF ENTRY	SUPPLIER POWERFUL (LEVERAGE)	BUYER POWERFUL (LEVERAGE)	SUBSTITUTE IS HIGH	RIVALRY IS HIGH		FACTORS
	Barriers to entry are advantages that incumbents have relative to new entrants - High Barriers = Threat is low = Industry Profitability atractive - Low Barriers = Threat is high = Industry Profitability moderate	- Powerful Suppliers = Threat is high = Industry profitability moderate - Unpowerful Suppliers = Threat is low = Industry profitability high	- Powerful Buyers (price sensitive) = Threat is high = Industry profitability moderate - Unpowerful Buyers = Threat is low = Industry profitability high	- Substitute threat is low = Industry profitability atractive - Substitute threat is high = Industry Profitability moderate	- Rivalry is high = Industry profitability limited - Rivalry is low = Industry profitability atractive		
	1. Supply-side economies of scale	1. Suppliers more concentrated than the industry it sells to	1. There are few buyers, or each one purchase in volumes that are large relative to the size of a single ve	1. It offers an attractive price-performance trade-off to the industry's product	1. Competitors are numerous or are roughlyequal in size and power		1. Industry growth rate
	These economies arise when firms that produce at larger volumes enjoy lower costs per unit because they can spread fixed costs over more units	2. Supplier group does not depend heavily on the industry for its revenues	2. The industry's products are standarized or undifferentiated	2. Buyer's cost of switching to the substitute is low	2. Industry grow slow		Common mistake is to assume that fast-growing industries are always attractive. Growth does tend to mute rivalry
	- Efficient technology - Better terms for suppliers - Research - Consumer marketing - Supply chain - Media advertising - National logistics - International logistics - Information technology	3. Industry participants face switching costs in changing suppliers	3. Buyers face few switching costs in changing vendors		3. Exit barriers are high		2. Technology and Innovation
	2. Demand-side benefits of scale	4. Suppliers offer products that are dirrerentiated	4. Buyers can credibly threaten to integrate backward and produce the industry's product themselves if v		4. Rivalry are highly committed to the business and have aspirations for leadership, espcially if they have		Advanced technology or innovations are not by themselves enough to make an industry structurally attractive or unattractive
	These benefits, also known as network effects, arise in industries where a buyer´s willingness to pay for a company's product increases with the number of other buyers who also patronize the company. Buyers may trust larger companies	5. There is no substitute for what the supplier group provides	BUYERS PRICE SENSITIVE		5. Firms cannot read each other's signals will because of lack of familiarity with one another, diverse appr		3. Government
	- Large base of customers - Force new comers to reduce price	6. Supplier group can credibly threaten to integrate forward into the industry	1. The product represents a significant fraction of its cost structure or procurement budget				Government involvement is neither inherently good not bad for industry profitability. The best way to understand the influence of government on competition is to analyze how specific government policies affect the five competitive forces.
	3. Customer switching costs		2. Buyer earns low profits, is strapped for cash, or is under pressure to trim its purchasing costs				4. Complementary products and servicces
	Switching costs are fixed costs that buyers face when they change suppliers		3. The quality of buyer's products or services is little affected by the industry's product		PRICE WAR	CUSTOMER VALUE	Complements can be important when they affect the overall demand for an undustry's product- The strategist must trace the positive or negative influence of complements on all five forces to ascetain their impact on profitability. Complements can raise or lower the barriers to entry. The presence of complements can also affect the threat of substitutes. Compolements can factor into industry rivalry either positively (as when they raise switching costs) or nefatively (as when they neutralize product differentiation).
	- Product specifications - Retrain employees to use a new product - Modify processes - Modify information systems - SAP or ERP systems - Embedded data		4. The industry's product has little effect on the buyer's other costs		Rivalry is specially destructive to profitability if it gravitates solely to price because price competition transfers profits directly from an industry to its customers. Sustained price competition also trains customer to pay less attention to product features or service.	Focus on improve customer value and can support higher prices. Rivalry focused on such dimensions can improve valye relative to substitutes or raise the barriers facing new entrants	
	4. Capital requirements				- Price discounting	- New Products - Advertising Campaigns - Service Improvements - Product features - Support services - Delivery time - Brand image	
	The need to invest large financial resources in order to compete can deter new entrants				PRICE COMPETITION		
	- Fixed facilities - Extend customer credit - Inventories - Fund start-up losses - Up-front advertising - R&D				1. Products or services of rivals are nearly identical and there are few switching costs for buyers		
	5. incumbency advantages independent of size				2. Fixed costs are high and marginal costs are low		
	Incumbents may have cost or quality advantages not available to potential rivals				3. Capacity must be expanded in large increments to be efficient		
	- Proprietary technology - Preferential access to raw materials - Favorable geographic locations - Brand identity - Cumulative experience				4. The product is perishable		
	6. Unequal acces to distributioon channels				ZERO SUM COMPETITION	POSITIVE SUM COMPETITION	
	The new entrant must secure distribution of its product or service				As important as the dimensions of revalry is whether rivals compete on the SAME dimensions. When all or many competitors aim to meet the same needs or compete on the same attributes, the result is ZERO-SUM COMPETITION. Here, one firm's gain is often another's loss, driving down profitability.	Rivalry can be positive sum, or actually incease the average profitability of an industry, when each competitor aims to serve the needs of different customer segments, with different mixes of price, products, services, features, or brand identities. Such competition can not only support higher average profitability bit also expand the industry, as the needs of more customer groups are better met. The opportunity for positie-sum competition will be greater in industries serving diverse customer groups.	
	- Fixed facilities - Extend customer credit - Inventories - Fund start-up losses - Up-front advertising - R&D						
	7. Restrictive government policy						
	Government policy can hinder or aid new entry directly, as well as amplify or nullify the other entry barriers.						
	- Licensing requirements - Restriction on foreign investment - Expansice patenting rules - Environmental regulations - Safety regulations - Subsidies - Funding research - Reducing scale of economies						
	8. Expected retaliation						
	How potential entrants believe incombents may react will also influence their decision to enter or stay our of an industry.						
	- Incumbents prevously responded vigorously - Incumbents possess substantial resources - Incumbents seem likely to cut prices - Industry growth slow so entrants gain volume only taking from incumbents						