

Worksheet 2

Porter's 5 Forces Analysis

Formulating strategy requires relating a company to its competitive environment. The five forces template provides structure when considering the issues that a client faces and will help you identify what factors influence profitability within its industry.

Because every client is amenable to an industry structural analysis, it forms an important part of your strategic toolkit.

Exercise 1:

Working as a group, select an industry and apply Porter’s 5 Forces to it by completing the exercise set out on the next page in relation to it. Notes are also provided over the page. If you have time, use this information to have a go at exercises 2 and 3.

**Selected industry……………………………………….**

Bargaining Power of Buyers

**... / 10**

Threat of New Entrants

... / 10

Bargaining Power of Suppliers

**... / 10**

Threat of Substitutes

**... / 10**

Rivalry among existing Competitors

**... / 10**

1. **Buyer Power:** Buyers have the ability to force down prices within an industry. If the businesses within an industry only compete on price or if they only deal with a few, powerful buyers, buyers will heavily erode profitability. In determining the strength of buyer power, some key questions are: ‘Does the business only compete on price or do they provide something unique?’ ‘How fickle are the buyers?’, ‘How much choice do buyers have?’, ‘How easy is it for buyers to compare prices?’

Describe the nature of the Buyer Power within the industry by stating how strong or weak it is and by briefly explaining your reasoning for coming to this conclusion. Then, on page 1, provide a score for the overall strength of Buyer Power within the industry on where ‘0’ represents a very weak force and ‘10’ represents a very high force.

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1. **Supplier Power:** Suppliers have the ability to push up costs. Supplier power is largely determined by the number of suppliers of each key input and the uniqueness of their product or service. The key questions are: ‘Who are the various types of supplier in this industry?’, ‘Is the business reliant on one or a few of these suppliers?’ and ‘How easy it is for these suppliers to drive up costs?’ Suppliers also include employees. You should ask ‘How skilled are the workforce?’ ‘Are there many similar businesses for which they could work?’ The more reliant a business is on a small pool of potential employees the more power they have to raise the costs of the business.

In the space provided below list the various key **Suppliers** within the industry and describe the nature of their bargaining power by stating how strong or weak it is and by briefly explaining your reasoning for coming to this conclusion. Then, on page 1, provide a score for the overall strength of supplier Power within this industry where ‘0’ represents a very weak force and ‘10’ represents a very high force.

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1. **Competitive Rivalry:** Competitors erode profitability as they force businesses to drive down their prices or drive up costs (to provide additional product features or raise service levels) in an attempt to outdo one another. Key questions are: ‘Who are the various competitors?’ ‘How intense is competitive rivalry’, ‘Are the goods or services in this industry generic? Are they perishable?’

In the space provided below list the various key **Competitors** within the industry and describe the nature of their bargaining power by stating how strong or weak it is and by briefly explaining your reasoning for coming to this conclusion. Then, on page 1, provide a score for the overall strength of Competitive Rivalry within the industry where ‘0’ represents a very weak force and ‘10’ represents a very high force.

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1. **Threat of New Entrants:** Profitability is also determined by the ease with which new businesses may enter the industry in question. Barriers to entry exist in many forms including economies of scale, specialist knowledge and market reputation. If barriers to entry are relatively low (as in the coffee retailing industry) businesses must continually invest in marketing and innovation to put off potential new entrants. This pushes up costs and reduces profitability. Key questions are ‘How easy is it for new entrants to break into this industry?’, ‘What are the barriers to entry in this industry?’ (e.g. supply side economies of scale, demand side economies of scale), ‘Does a threat of new entrants force existing industry competitors to keep costs to a minimum and / or spending on new product development, marketing and advertising to a maximum?’

In the space provided below list the various **potential new entrants** within the industry and describe the nature of this force by stating how strong or weak it is and by briefly explaining your reasoning for coming to this conclusion. Then, on page 1, provide a score for the overall strength of Threat of New Entrants within this industry where ‘0’ represents a very weak force and ‘10’ represents a very high force

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1. **Threat of Substitutes:** Substitutes can act as a price ceiling for an entire industry. This is because if prices are set too high and there is a viable substitute which offers similar benefits for a lower price then buyers will switch to the substitute. Key questions are: ‘What are the potential substitutes?’, ‘Are the benefits they provide similar enough to place a price ceiling on what a business can charge?’

In the space provided below list the various **substitutes** within your sector and describe the nature of this force by stating how strong or weak it is and by briefly explaining your reasoning for coming to this conclusion. Then, on page 1, provide a score for the overall strength of Threat of Substitutes within this industry where ‘0’ represents a very weak force and ‘10’ represents a very high force.

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Exercise 2:

Select the most appropriate strategies for dealing with each of the forces within this industry:

**Buyer Power**

* + Differentiate products / services from those of competitors (e.g. Paccar)

Specify means for differentiation……………………………………………………………………………

* + Market to end user in order to put pressure on buyers (e.g. Intel)
  + Purchase a competitor (e.g. TUI Travel owns First Choice and Thompson)
  + Form a consortium with other competitors (e.g. farmers to reduce supermarket power)
  + Tie buyers in with long term agreements (e.g. Gym Membership)
  + Increase customer loyalty / make switching more difficult (e.g. Nectar card / Boots card)
  + Provide lowest price offering whilst maintaining margin (e.g. Ryan Air, Stagecoach)
  + Exploit demand side economies of scale (e.g Facebook, ebay, Twitter)
  + Make it difficult for buyers to compare prices (e.g. Mobile Providers), avoid price comparison sites (e.g. Direct Line Insurance)

Specify any other possible strategies for reducing Buyer Power:

1 ……………………………………………………………………………

2 …………………………………………………………………………..

3 …………………………………………………………………………..

**Supplier Power**

* + Outsource manufacturing to where it is cheaper (e.g. Manufacturing to Asia)
  + Develop Automated Manufacturing Processes (e.g. Electronics - Japan)
  + Standardise specifications for parts to make supplier switching easier (e.g. car manufacturing)
  + Purchase a supplier (vertical integration)(e.g. Cobra Beer, TUI Travel)
  + Search for lowest cost suppliers (e.g. Lidl)
  + Bind-in suppliers and prevent them from working with competitors (e.g. exclusivity agreements, restrictive covenants, garden leave clauses)
  + Maximise resource utilization (e.g. Southwest Airlines)
  + Efficient Supply Chain Management (e.g. Tesco, Primark)
  + Grow the business (organically / acquisition) & generate supply side economies of scale (e.g. Pepsi)
  + Buy and sell derivatives to secure dependable prices (e.g. energy/commodities)
  + Get the end users to go to work for you (e.g. Supermarket self-checkout, Amazon Customer reviews, IKEA self-selection, transport and assembly)

Specify any other possible strategies for reducing Supplier Power:

* 1 ……………………………………………………………………………
* 2 …………………………………………………………………………..
* 3 …………………………………………………………………………..

**Competitive Rivalry**

*(note that several of these strategies have been taken from the Buyer Power and the Supplier Power strategies. This is because, as well as dealing with these specific profit constraints, these strategies will also provide a business with a competitive advantage.)*

* Develop an industry standard (e.g. Qualcomm, Microsoft, Google (Android))
* Protect IP (e.g. patent registration)
* Retaliation Tactics (e.g. sell at loss to price competition out of market)
* Form alliances with linked / complimentary businesses/organisations (e.g. Games developers)
* Differentiate products / services from those of competitors (e.g. Paccar)

Specify means for differentiation……………………………………………………………………………

* + Purchase a competitor (e.g. TUI Travel owns First Choice and Thompson)
  + Tie buyers in with long term agreements (e.g. Gym Membership)
  + Increase customer loyalty / make switching more difficult (e.g. Nectar card / Boots card)
  + Provide lowest price offering whilst maintaining margin (e.g. Ryan Air, Stagecoach)
  + Exploit demand side economies of scale (e.g Facebook, ebay, Twitter)
  + Make it difficult for buyers to compare prices (e.g. Mobile Providers), avoid price comparison sites (e.g. Direct Line Insurance)
  + Outsource manufacturing to where it is cheaper (e.g. Manufacturing to Asia)
  + Develop Automated Manufacturing Processes (e.g. Electronics - Japan)
  + Standardise specifications for parts to make supplier switching easier (e.g. car manufacturing)
  + Purchase a supplier (vertical integration)(e.g. Cobra Beer, TUI Travel)
  + Search for lowest cost suppliers (e.g. Lidl)
  + Bind-in suppliers and prevent them from working with competitors (e.g. exclusivity agreements, restrictive covenants, garden leave clauses)
  + Maximise resource utilization (e.g. Southwest Airlines)
  + Efficient Supply Chain Management (e.g. Tesco, Primark)
  + Grow the business (organically / through acquisition) & generate supply side economies of scale (e.g. Pepsi)
  + Buy and sell derivatives to secure dependable prices (e.g. energy/commodities)
  + Get the end users to go to work for you (e.g. Supermarket self-checkout, Amazon Customer reviews, IKEA self-selection, transport and assembly)

Specify any other possible strategies for reducing Competitive Rivalry:

* 1 ……………………………………………………………………………
* 2 …………………………………………………………………………..
* 3 ………………………………………………………………………….

**Threat of New Entrants**

* + Protect IP (e.g. patent registration)
  + Tie up raw materials / Take on the best employees (e.g. Google)
  + Tie up channels with exclusivity agreements (e.g. Southwest Airlines)
  + Develop an industry standard (Qualcomm, Microsoft, Google (Android))
  + Exploit Demand Side Economies of Scale (e.g. Facebook, ebay, Twitter)
  + Exploit Supply Side Economies of Scale (e.g. Pepsi)
  + Retaliation Tactics (sell at loss to price new competition out of market)
  + Form alliances with linked / complimentary products (e.g. Games developers)
  + See Competitive Rivalry Strategy(ies)……………………………………………………………………….

Specify any other possible strategies for reducing the Threat of New Entrants:

* 1 ……………………………………………………………………………
* 2 …………………………………………………………………………..
* 3 ………………………………………………………………………….

**Threat of Substitutes**

* + Accentuate differences through marketing and advertising (e.g Train over Car)
  + Adopt benefits provided by substitutes (e.g. Southwest Airlines – frequent departures, B&Q – as easy to install yourself as to use builders but cheaper)
  + Enhance product features to ensure substitute is not determined to be a valid replacement (e.g. David Lloyd / Holmes Place (fitness classes, restaurant bar, swimming pool, beauty spa))
  + Customer tie-ins / Create loyalty (e.g. David Lloyd, Holmes Place - gym membership contracts)

Specify any other possible strategies for reducing the Threat of Substitutes:

* 1 ……………………………………………………………………………
* 2 …………………………………………………………………………..
* 3 …………………………………………………………………………

Exercise 3:

Discuss the following with your group: Are there certain industries in relation to which you are more commonly involved? If so, what are they? How well would you say you know the key commercial issues faced by the businesses operating within those industries? Consider a specific client matter that you are currently working on. Can you think of any ways in which having a deeper understanding of the client’s industry forces could be helpful?

Exercise 4:

Although it is widely used by strategists, management consultant and business advisors, Porter’s 5 Forces has received two main criticisms. What do you think these might be?

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2. ....................................................................................................................................................................