Porter's Introduction

- Whether or not it knows, every firm competing in an industry has a competitive strategy.
  - It may have developed explicitly, or
  - It may have evolved implicitly through the activities of the various functional departments.
- Left to its own devices, each functional department will pursue approaches that are dictated by its professional orientation.
- However, the sum of these individual functional department approaches (strategies) rarely equals the best strategy for the overall organization.

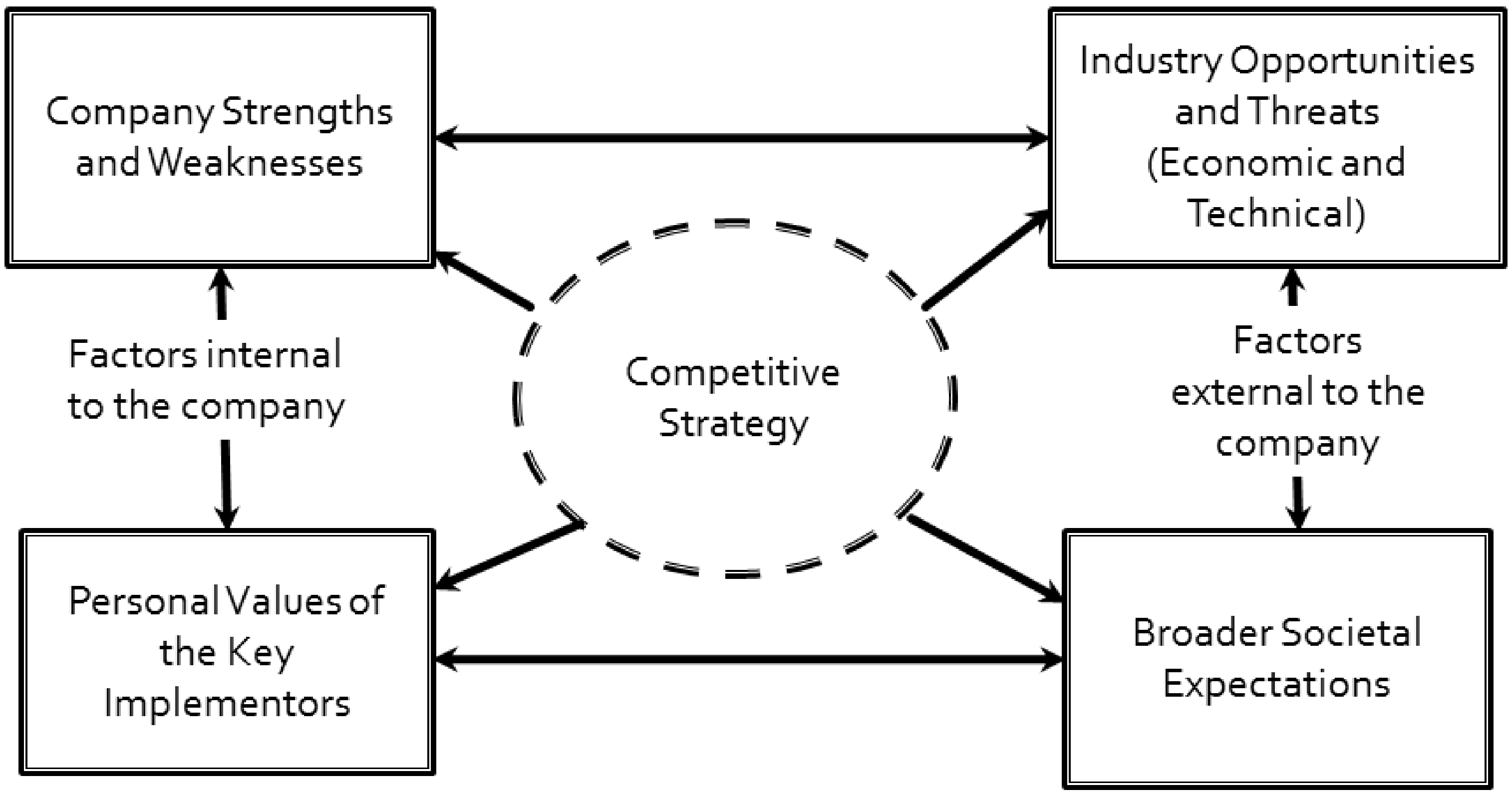
The Classic Approach
According to Porter

- The strategy for the organization is a composite of the strategies of its individual departments.
- The strategy is essentially a "bottom up" approach.
- Porter presents "The Wheel of Competitive Strategy" (on the next slide) to illustrate what he calls the Classic Approach.
- Porter also describes the "Context in Which Competitive Strategy is Formulated" (on the slide after next).

The Wheel of Competitive Strategy
According to Porter

Context in Which Competitive Strategy is Formed

According to Porter



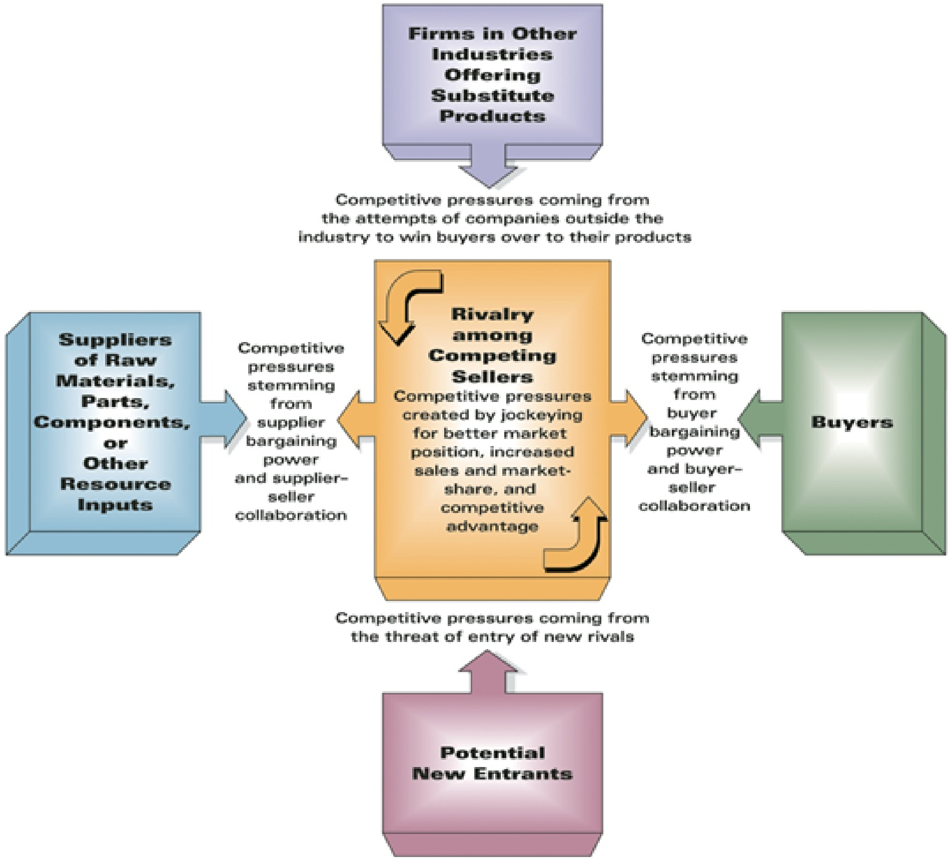
The Structural Analysis of Industries

- The essence of formulating competitive strategy is relating a company to its environment.
- Although the relevant environment is very broad, encompassing social as well as economic forces, the key aspect of the firm's environment is the industry or industries in which it competes.

The Structural Analysis of Industries (cont'd)

- The intensity of competition in an industry is neither a matter of coincidence nor bad luck.
- Rather, competition in an industry is rooted in its underlying economic structure and goes well beyond the behavior of current competitors.
- The state of competition in an industry depends on five basic competitive forces (see the next slide).

Forces Driving Industry Competition
Porter's Five Forces Model



Competitive Rivalry

- This "box" in the chart contains the subject company.
  - Competitors in this box are those who compete specifically with the subject company's products in the subject company's markets.
- In order to get a correct assessment of the competitive situation, the "box" and the remainder of the chart <u>must</u> be completed for each product/market.

Competitive Rivalry (cont'd)

- Rivalry occurs because one or more competitors either feels the pressure or sees the opportunity to improve its competitive position in the market.
- In most industries, competitive moves by one firm have a noticeable effect on its competitors and thus may incite retaliation or efforts to counter the move.

Competitive Rivalry (cont'd)

- Intense rivalry is the result of a number of interacting structural factors.
  - Numerous or equally balanced competition
  - Slow industry growth
  - High or fixed storage costs
  - Lack of differentiation or switching costs
  - Capacity augmented in large increments
  - Diverse competitors
  - High strategic stakes
  - High exit barriers

Potential New Entrants

- Potential new entrants are companies that might have the capability and interest to enter the industry.
- New entrants to an industry bring new capacity, the desire to gain market share, and often substantial resources.
- The threat of entry into an industry depends on the *barriers to entry* that are present, coupled with the reaction of competitors that the entrant can expect.

Potential New Entrants (cont'd)

- If barriers are high and/or the newcomer can expect sharp retaliation from entrenched competitors, the threat of entry is low.
- There are six major sources of barriers to entry:
  - Economies of scale
  - Product differentiation
  - Capital requirements
  - Switching costs
  - Access to distribution channels
  - Cost disadvantages independent of scale
  - Government policy

Pressure from Substitute Products

- A substitute product is one that is <u>not the same</u> as the product offered by the subject company, but is one that customers of the subject company's product perceive to be an alternative to the company's product.
  - That is, the substitute can fulfill the same customer need as the subject product.
  - For example, Coca-Cola competes with its archrival Pepsi for the cola market, but water is a substitute for cola sodas.

Bargaining Power of Buyers

- Buyers in this "box" are those who currently buy the company's or the company's competitors product.
  - Those companies that are in the Rivalry "box."
- Buyers affect industry competition by forcing down prices, bargaining for higher quality or more services, and playing competitors against each other.
  - All of these affect industry profitability.

Bargaining Power of Buyers (cont'd)

- Buyers are powerful under the following circumstances.
  - A buyer that purchases large amounts of a seller's sales.
  - The products the buyer purchases represent a significant fraction of the buyer's costs or purchases.
  - The products are standard or undifferentiated.
  - There are few switching costs.
  - The buyer earns low profits.
  - Buyers pose a credible threat of backward integration.
  - The industry's product is unimportant to the quality of the buyer's products or services.
  - The buyer has full information on the product.

Bargaining Power of Suppliers

- A supplier is a company that provides products or services to the subject company or its competitors.
- Suppliers can exert power over a company by threatening to raise prices, reduce quality, or no longer supply.
  - Powerful suppliers can squeeze profitability out of an industry that is unable to recover cost increases in its own prices.

Bargaining Power of Suppliers (cont'd)

- The conditions making suppliers powerful tend to mirror those making buyers powerful.
  - The suppliers are dominated by a few companies and are more concentrated than the industry that purchases its supplies.
  - The buying industry has no substitutes for the suppliers' products.
  - The buying industry is not an important customer of the supplying industry.
  - The suppliers' product is an important input to the buyer's business.
  - The suppliers' products are differentiated or have high switching costs.
  - The suppliers pose a credible threat of forward integration.