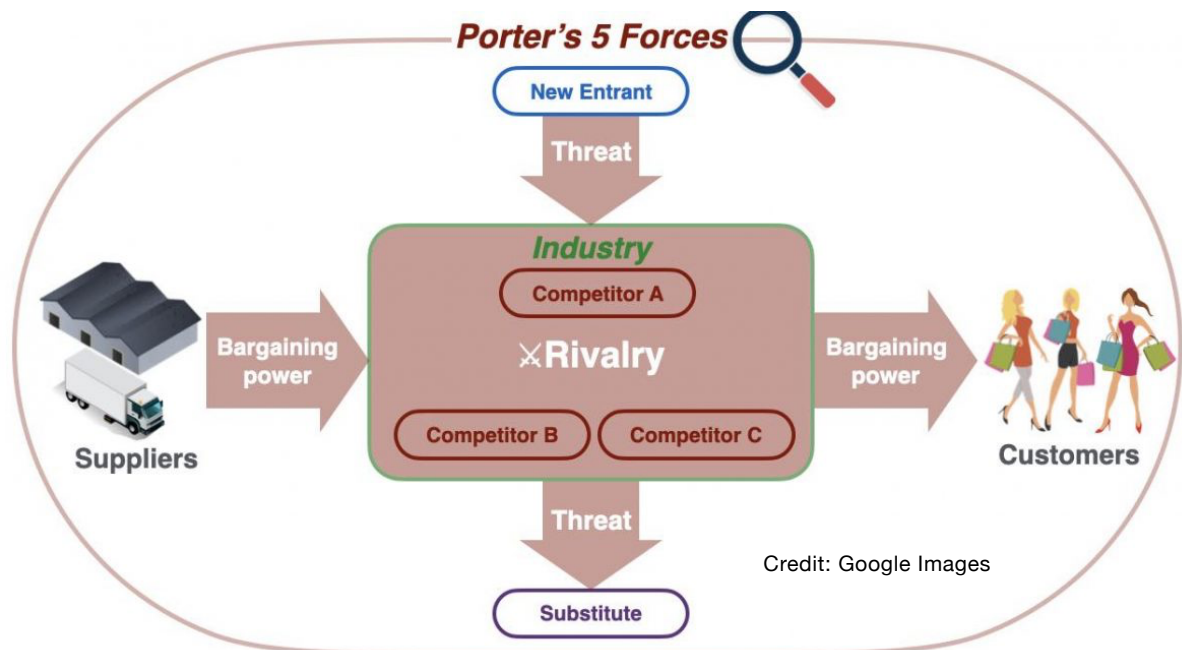


# Porter's five forces

A competitive advantage analysis management tool may be combined with RGV (or VRIO) & PESTEL to get the desired results



In his first book, “Competitive Strategy” (1980), Mr Porter asked how companies can secure long-term competitive advantage. At the time, thinking on this subject was dominated by two conflicting schools. The Harvard Business School urged companies to adjust to their unique circumstances. The Boston Consulting Group argued that planning can be based on a universal principle, the experience curve: the more a firm knows about a market, the more it can lower its price and increase its market share. Mr Porter tried to find a middle way between these extremes. He studied individual companies, but set them in the context of their industry. He outlined “generic strategies”, but emphasised that different firms must choose different paths to success. He drew upon industrial economics, but offered specific advice to practising managers<sup>1</sup>. Porter's Five Forces is a model that identifies and analyzes five competitive forces that shape every industry and helps determine an industry's weaknesses and strengths. Five Forces analysis is frequently used to identify an industry's structure to determine corporate strategy. Porter's model can be applied to any segment of the economy to understand the level of competition within the industry and enhance a company's long-term profitability<sup>2</sup>. Porter's Five Forces is a framework for analyzing a company's competitive environment keeping in mind the number & power of a company's competitive rivals, potential new market entrants, suppliers, customers, and substitute products impacting a company's profitability.

<sup>1</sup>Economist - Oct 8th 1994 (Updated Nov 19th 2009)

<sup>2</sup> [investopedia.com](https://www.investopedia.com)

Strategy management professionals may consider to tailor made this tool to guide business strategy to increase competitive advantage. Major contending forces those determine the state of competition in an industry: the threat of new entrants, the bargaining power of customers and of suppliers, the intense rivalry of competitors, and the threat of substitute services or products. Once the corporate strategist has assessed these forces, he can identify his own company’s strengths and weaknesses and act accordingly to put up the best defence against competitive assaults<sup>3</sup>. The state of competition in an industry depends on five basic forces, which are diagrammed adjacently. The collective strength of these forces determines the ultimate profit potential of an industry. It ranges from *intense* in industries like Airlines industries, LED lamps, metal cans, EPC business, FMCG goods where no company earns spectacular returns on investment, to *mild* in industries like oil field services and proprietary equipment, where there is room for quite high returns. Hence there is a need to emphasis to formulate a strategy to determine the profitability. for example a company having a strong position in the market though may earn low return if it faces a newer superior or lower cost product.

### Forces Governing Competition in an Industry



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To build the strategic analysis, let us firstly build strength of each competitive forces. The various attributes for the calculation may cover on the following lines. You may have to

### Porter’s 5 Forces Analysis

A few characteristics are critical to the strength of each competitive force

<p style="text-align: center; font-weight: bold; margin: 0;">Supplier Power</p> <ol style="list-style-type: none"> <li>1. Dominance by few companies</li> <li>2. Its product is unique &amp; has a cost to switching by buyers</li> <li>3. Buyer is not an important company of the supplier</li> <li>4. Supplier poses a credible threat of integrating into the buyer’s business</li> </ol>	<p style="text-align: center; font-weight: bold; margin: 0;">Threat of New Entry</p> <ol style="list-style-type: none"> <li>1. Economic of scale</li> <li>2. Product differentiation</li> <li>3. Capital requirements</li> <li>4. Cost disadvantages independent of size</li> <li>5. Access to distribution channel</li> <li>6. Government policy</li> </ol>	<p style="text-align: center; font-weight: bold; margin: 0;">Buyer Power</p> <ol style="list-style-type: none"> <li>1. Purchases large volumes</li> <li>2. Buying standard products</li> <li>3. Buying product - significant portion of cost</li> <li>4. Buyer earns a lower profit</li> <li>5. Product is unimportant to buyer’s product</li> <li>6. Buyer poses a credible threat of backward integration</li> </ol>	<p style="text-align: center; font-weight: bold; margin: 0;">Threat of Substitutes</p> <ol style="list-style-type: none"> <li>1. Substitutes not only limit the profit but also reduce the upside in boom times</li> <li>2. Substitutes are subject to trends improving price performance</li> <li>3. Produced by high profit earning companies</li> <li>4. Higher performance</li> </ol>
<p style="text-align: center; font-weight: bold; margin: 0;">Competitive Rivalry</p> <ol style="list-style-type: none"> <li>1. Competitors are many or equal in size &amp; power. Industry growth is slow and products lack differentiation</li> <li>2. Fixed costs are high or product is perishable. Capacity augmentation is in large increments and</li> <li>3. Exit barriers are high</li> <li>4. Rivals are diverse in strategies and have different ideas to compete &amp; run head on to each other in the process</li> </ol>			

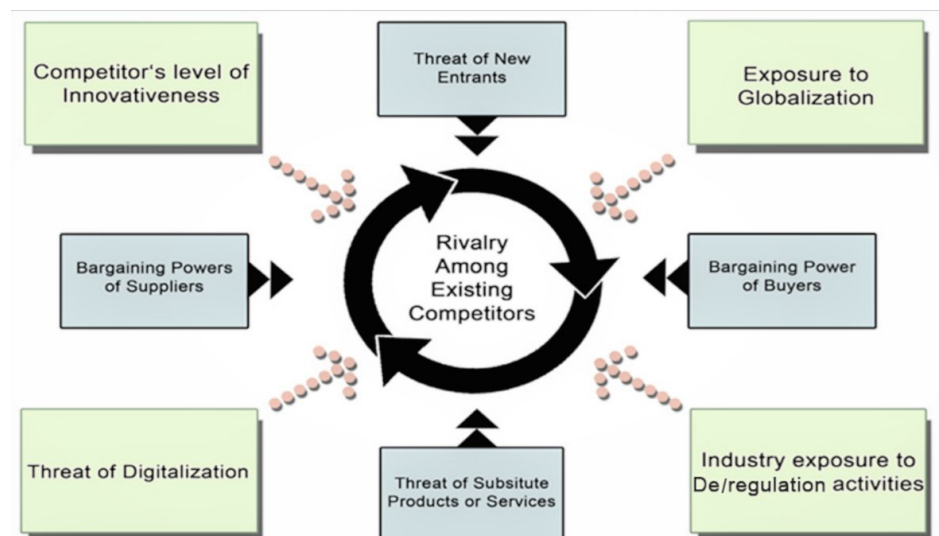
<sup>3</sup> HBR March-April 1979 : How Competitive Forces Shape Strategy by Michael E. Porter

amend the attributes as per the need of your company. However, a suggested approach is to construct a quantitative table based on weighted attributes analysis method. My typical advise to the strategy manager would be to assign an appropriate weightage factor for issues like govt barriers for entry or exit. Please also keep in mind the “Life cycle of business” curves and what stage a company is because as industry matures, its growth rates changes resulting into lower profits.

**F**ormulation of the strategy is the next step after assessing the forces. The crucial strengths and weaknesses from a strategic standpoint are the company’s posture vis-à-vis the underlying causes of each force. Then the strategist can devise a plan of action that may include (1) positioning the company so that its capabilities provide the best defence against the competitive force; and/or (2) influencing the balance of the forces through strategic moves, thereby improving the company’s position; and/or (3) anticipating shifts in the factors underlying the forces and responding to them, with the hope of exploiting change by choosing a strategy appropriate for the new competitive balance before opponents recognize it.

In the recent years, this strategy tool has been critically argued that it has not kept the pace with the time and has been further modified keeping the requirements of the time. In a paper<sup>4</sup> published in Technology Innovation Management Review, the authors studied Mining & IT industry. They argued to include four more factors as per below in the original Porter’s five forces being

1) competitors level innovations; 2) Exposure to globalisation; 3) Threat of digitisation and 4) industry exposure to de/regulation activities. My years of business experience suggests that one has to modify the characteristics as well as forces suiting the specific needs of your industry keeping in mind the original objectives & spirit



of the Porters five forces principles. For example, I am also working to include the ESG score additionally in the forces so as to ascertain the funding capabilities of the rivals. In my own industry experience, I believe the tool if assessed properly for the forces’ characteristics, provide an optimal direction for a robust strategy for achieving the company position with higher profits. Over the years<sup>5</sup>, many additional strategic models have been developed by scholars and practitioners to create win-win situations in national and international markets and industry environments. For instance, the three models

<sup>4</sup> Is Porter's Five Forces Framework Still Relevant? A study of the capital/labour intensity continuum via mining and IT industries Diane Isabelle, Kevin Horak, Sarah McKinnon, Chiara Palumbo, TIMR June 2020, Vol 10, Issue 6.

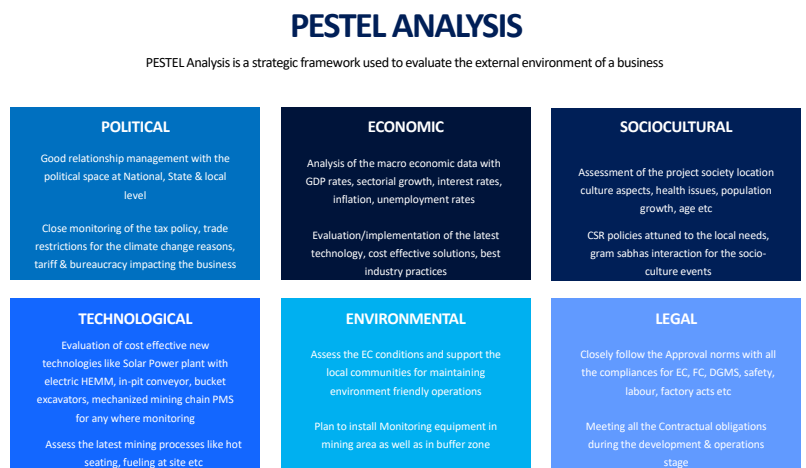
<sup>5</sup> The Relevance Of Porter’s Five Forces In Today’s Innovative And Changing Business Environment by Gerard H. Th. Bruijl 07 June 2018

randomly chosen are (a) resource-based view (RBV), (b) the delta model, and (c) blue ocean strategy.

As Porter’s five forces pertains to an outside-in approach, other models may express a more inside-out approach where organizational inner strength and abilities may generate long-term sustainability. RBV approach insinuates that organizations should position themselves strategically based on their value, uniqueness, inimitable and non-substitutable resources and capabilities rather than the products and services derived from those resources and capabilities. In other words, as an inside-out model, RBV’s strategy is directed at leveraging resources and capabilities across many markets and products instead of targeting specific products for precise markets. The Delta Model believes that customers are the ultimate repository of any organizational activity and that customers are at the core of strategy. Delta Model emphasizes the importance of attracting, satisfying and retaining customers. The Delta Model portrays three positions opening the mindset to a new arrangement of strategic options, which are (a) best product, (b) total customer solution, and (c) system lock-in whereby each element represents a different approach. The first mover approach model making competitors irrelevant rather than trying to outdo them is the blue ocean strategy. When developing a strategy, many organizations may well have numerous internal discussions whether it is best to pursue an innovation strategy or a competitive strategy.

Porter’s five forces model should be further developed in combination with i) PESTEL (evaluating the external factors to the organisation) and ii) RBV or VRIO (evaluating the internal factors to the organisation) to get the desired results.

Combining PESTEL analysis with Porter five forces may help to provide the detailed picture of the situation with an organisation. PESTEL (Political, Economic, Social, Technology, Legal & Environmental) analysis enables to create a list of potential issues within the macro-ecosystem which potentially may impact the organisation whereas thorough understanding of the competitors and competitive market, a Porters five forces analysis may be conducted to achieve the best results. Just to give an idea on the PESTEL analysis, the slide gives a bird’s eye view prepared for one of our advisory for a coal mining company. As mentioned that it is an external environment assessment strategy tool works perfectly well if it is combined with the Porters five forces.

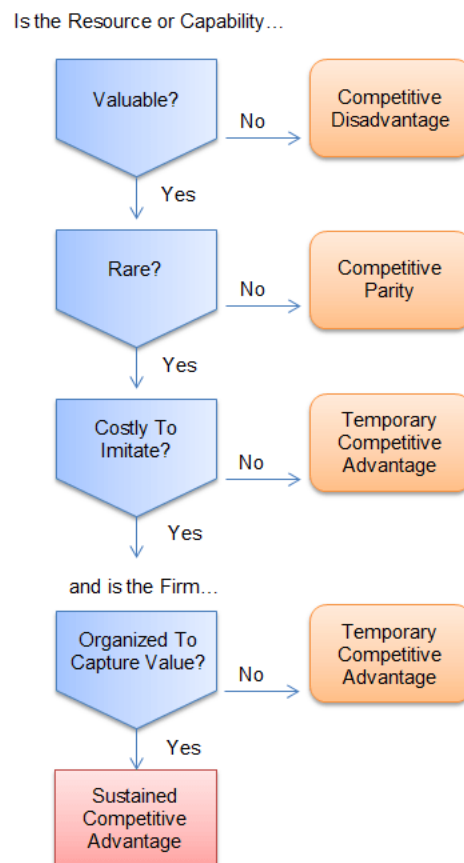


Resources and capabilities in resource-based view (RBV) strategy are deemed as a source from which the organization derives several products for various markets. In other words, as an inside-out model, RBV’s strategy is directed at leveraging resources and capabilities

across many markets and products instead of targeting specific products for precise markets. Moreover, if resources are revealing characteristics of VRIO, an organization may gain and maintain a competitive advantage. RBV represents a relationship between resource heterogeneity and immobility, VRIO and sustained competitive advantage.

VRIO is a question framework containing resource and capability questions about value, rarity, imitability, and organization to ascertain competitiveness. The tool was originally developed by Barney, J. B. (1991) in his work 'Firm Resources and Sustained Competitive Advantage', where the author identified four attributes that firm's resources must possess in order to become a source of sustained competitive advantage. According to him, the resources must be valuable, rare, imperfectly imitable and non-substitutable. As Porter's five forces model underlines actions by organizations by developing a privileged market or industry position combatting competitive forces, RBV (or VRIO) points towards building a competitive advantage and seizing higher profits from fundamental organizational-level resources and capabilities. RBV and Porter's five forces

may appear to be different, but both models may complement each other when integrated (Wernerfelt, 1984). Hence, as both models underscore different dimensions of strategy, they do not include customers. Arguably, the latter may cause confusion as Porter's model elaborate about "buyers," whose bargaining power we should resist or reduce, but, in that respect, customers form a different element of the rivalry. The RBV assists in evaluating the ability to utilize strengths and responds to identified weaknesses while the position approach and industry structure assist an organization to recognize its competitive environment. Arguably, to some extent Apple, Inc. and Tesla, Inc. may have some of the hallmarks of a combination of Porter's five forces and the RBV approach by having developed a strong market position and utilizing organizational-level resources and capabilities to enhance a competitive advantage. In sum, in today's hyper-competitive business environment, both Porter's five forces model and the RBV could be important tools for an organization when seeking a competitive advantage whereby one should not discard the other, but integrate them and make them complementary.



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*Author, an Engineer, Management, Law graduate & Masters in Economics (under completion) is presently Managing Partner at MANROM Consult LLP and has over 35 years of corporate experience in CXO positions as a business leader who has dealt in various functions like Management Consulting, Strategy, Operations (with P&L responsibility), Business development, strategic alliances, JVs, M&A, Project development, Legal and HR in various sectors like Energy (Power), Resources, Steel, Non-ferrous, Infra-structure, Technology, EPC & Corp Insolvency matters. Author has keen interest in global macro-economics and geo-political-business matters. For further interest, please write at "[advisory@manrom.in](mailto:advisory@manrom.in)"*

<sup>6</sup> The Relevance Of Porter's Five Forces In Today's Innovative And Changing Business Environment by Gerard H. Th. Bruijl 07 June 2018