FOUR
Michael Porter

Michael Porter is a well known strategy guru. He is Harvard University's youngest tenured professor. Every strategy student can recite his 'Five Forces' model of competitiveness.

Porter built his reputation mainly by writing on strategy. All strategy students have to study Porter as a basic course requirement. His books include '*Competitive Strategy: Techniques for Analysing Industries and Competitors* (1980); '*Competitive Advantage: Creating and Sustaining superior Performance*' (1985); '*Competitive Advantage of Nations*' (1990); and numerous articles in the Harvard Business Review. His books adorn the shelves of Chief Executives, politicians, academics and business management students. He has been commissioned by the DTI and the Economic and Social Research Council to address the productivity gap as far as UK is concerned.

He has been appointed to a University Professorship, the highest professional distinction for a Harvard faculty member.

As a strategy guru he is included in this book because of his contribution on how firms compete and gain competitive advantage. Competition is a key aspect of marketing. According to Harvard University Gazette, his book '*Competitive Strategy: Techniques for Analysing Industries and Competitors*' is considered the pioneering treatise on corporate competition and strategy.

What does '*The Witch Doctors*',[23] say about Michael Porter?

> *'Porter's work does not lend itself to one-line summaries, yet, underneath all his lists and copious examples, there is arguably a fairly simple message. The essence of strategy is really about making a choice between two different ways of competing. One choice is market differentiation, competing on the basis of value added to customers, so that people will pay a premium to cover higher costs. The other choice is cost-based leadership, offering products or services at the lowest cost. Though quality and service is never irrelevant, reducing cost is the major focus of the second sort of organisation; and vice versa for the first. Porter's data showed that firms with a clear strategy performed better than those that either lacked a clear strategy or that consciously tried to follow both paths (i.e. lead the way in price and quality).'*

Porter's Five Forces and marketing

Every student of strategy and marketing strategy should be conversant with Porter's five forces. In order to construct a competitive strategy, an organisation needs to know what is likely to happen in the markets in which the organisation delivers its products and services. It also has to know who its competitors are in a particular industry structure.

Porter's Five Forces

In any industry the rules of the competition are governed by five competitive forces. These are:

1 potential entrants,

2 competitive rivalry,

3 substitutes,

4 the bargaining power of buyers,

5 the bargaining power of suppliers.

These five forces address the question 'why are some markets more attractive than others?' The collective strength of these five competitive forces determines the ability of firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital.

What constitutes these five forces?

1 POTENTIAL ENTRANTS

For potential entrants to any markets there are various barriers to overcome. These barriers arise due to economies of scale, product differentiation, capital requirements, and access to distribution channels, switching costs, government policies, experience, brand strength, and retaliation.

2 SUBSTITUTES

Direct and indirect substitutes. The more substitutes there are the less intense the competition will become.

3 COMPETITIVE RIVALRY

The strength and intensity of competition among the firms will depend on the number of firms operating in an industry sector. The factors which influence the competition are the number of firms and the key players, seller concentration, the relative size of the firms, market share, profitability, margins earned, added value, excess capacity available, and the strength of the brands.

4 BARGAINING POWER OF BUYERS

The factors include the demands for quality; playing off competitors; buyer concentration; are products a significant element in buyer costs? Buyers' price sensitivity; power of suppliers relative to buyers.

5 BARGAINING POWER OF SUPPLIERS

Few or many companies supplying customer firms; profitability of suppliers and capacity and utilisation; can suppliers integrate forward? High switching costs.

Using Porter's five forces framework, organisations can analyse and understand competition in a particular industry.

> *'All five forces jointly determine the intensity of industry competition and profitability, and the strongest force or forces are governing and becoming crucial from the point of view of strategy formulation. For example, even a company with a very strong market position in an industry where potential entrants are no threat will earn low returns if it faces a superior, low-cost substitute. Even with no substitutes and blocked entry, intense rivalry among existing competitors will limit potential returns...'*
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> **Source:** *Porter, Michael. (1980) 'Competitive Strategy.'*

Marketing is about satisfying consumer needs. Private organisations would like to be effective in their marketing in order to make profits. Not-for-profit organisations would like to satisfy consumer needs in order to satisfy the mandate set for them either by government or sponsors.

Effective marketing depends on doing proper consumer research and also conducting industry and competitor analyses. This is why Porter's Five Forces framework becomes a useful tool in planning marketing strategy.

Apart from undertaking industry and competitive analysis, Porter also advises to focus on competitors. Organisations need to analyse who their key competitors are, what are their current strategies, what drives the competitors, what is their current profile, what capabilities they possess and what are their future intentions.

Pay attention to 'Market Signals.'

'A market signal is any action by a competitor that provides a direct or indirect indication of its intentions, motives and goals, or internal situation. The behaviour of competitors provides signals in a myriad of ways. Some signals are bluffs, some are warnings, and some are indirect means of communicating in the market place, and most if not all of a competitor's behaviour can carry information that can aid in competitors analysis and strategy formulation.'

Source: *Porter, Michael (1980). 'Competitive Strategy'.*

Doing intelligence work on competitors involves the systematic collection, collation, evaluation and use of intelligence about competitors.

How to conduct competitors' analysis

The following process reflects the five stages of conducting competitor analysis:

1. **Plan**. Decide what it is you are after.
2. **Collect**. Gather information on your key competitors. Information can be obtained from annual reports, investment analysis reports, company literature, competitor advertising, trade associations, customers, sales people and conferences.
3. **Process**. Process the information gathered.
4. **Evaluate**. Do detailed evaluation of information processes in terms of its reliability, appropriateness and usefulness.
5. **Communicate**. Communicate your findings to those who should know.

Strengths and weaknesses of conducting competitor analysis

STRENGTHS

- Companies are kept on their toes.
- Companies become aware of what competition is like and what their competitors are doing.
- Companies find out how their competitors are performing compared with their own performance.
- Helps the companies to refine and fine-tune their competitive strategy.
- It provides focus in relation to corporate strategy.
- Information can be used to conduct benchmarking in order to adopt best practice.
- The information reinforces marketing plan.

WEAKNESSES

- Some companies become bogged down by getting too much information and not doing anything with it. 'Too much analysis creates paralysis.
- Some get too involved in analysing information gathered to the extent that they do not spend enough time in their own businesses.
- Some undertake competitor analysis as a window-dressing exercise.
- Some collect very good information but do not follow it up with action plans and subsequent implementation.

Criticisms of Porter's Five Forces Framework

- Porter emphasised the need for a company to build a strategy in the context of the forces shaping its industry's profitability, while Gary Hamel and C. K. Prahalad (both leading strategy gurus – see Grundy's 'Gurus on Strategy') have emphasised instead the need for a company to identify its core competencies and build strategy around them.
- The framework is static in nature in a sense that it views industry structure as stable and externally determined.
- Differences in industry profitability do not necessarily determine the profitability of the organisation within them.
- It highlights competition at the expense of collaboration.
- Industry structure is also influenced by the dynamic nature of competition.
- The quality of strategic thinking in an organisation may be more important than industry structure in determining the overall performance of an organisation.