

EE481: Industrial Economics

Porter's Five Forces Model (Applied from Amitashu Srivastava

<<http://www.slideshare.net/amitanshu/porters-5-force-model>>)

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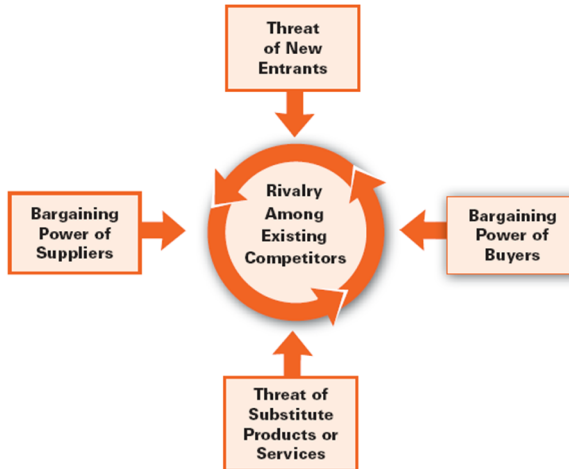
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Overview

- Porter's Five Forces model was introduced by Michael E. Porter in 1979.
- Use Industrial Organization concepts to analyze business environment.
 - Helps firms design competition strategies
 - Helps firms design business plans
 - Helps prospective entrants evaluate their entry decision

The Five Forces

The Five Forces That Shape Industry Competition



Threats of New Entrants

This is the same thing as analyzing barriers to entry

- Economies of Scale
- Product Differentiation
- Capital Requirements
- Customer Switching Costs
- Access to Distribution Channels
- Government Policy
- Expected Retaliation

Bargaining Power of Suppliers

Suppliers exert power in the industry by

- Threatening to raise prices or to reduce quality
- Suppliers can squeeze industry profit if their industry is not competitive but downstream industry is competitive.

Bargaining Power of Suppliers

Suppliers have market power when

- Their industry is concentrated (not many firms)
- Their products have few substitutes
- Buyers' industry (downstream industry) is competitive relative to the suppliers' industry.
- Suppliers' product is a important input to buyers' products.
- Suppliers' products are differentiated
- Suppliers' products have high switching costs

Bargaining Power of Buyers

Buyer groups are likely to be powerful if

- Buyers are concentrated
- Purchase accounts for a significant fraction of supplier's sales
- Products are undifferentiated
- Buyers face few switching costs
- Buyer presents credible threat of backward integration
- Buyer has full information

Threat of Substitute Products

Products with similar function limit the prices firms can charge.

- Substitute products - have good price/performance tradeoffs relative to present industry products
- Examples of new substitutes that can replace the old product:
 - lighter in place of matches
 - CCTV, electronic security system in place of security guards
 - Smartphone scanner application in place of actual scanners.

Rivalry among existing competitors

Characteristics of intense competition

- Firms adopt price competition
- Firms stage advertising battles
- Increase consumer warranties or service
- Making new product introductions
- etc.

Reference and Further Reading

-  Porter M.E. The Five Competitive Forces That Shape Strategy. *Harvard Business Review*, January 2008.
-  Porter M.E. How Competitive Forces Shape Strategy, *Harvard Business Review*, March/April 1979.