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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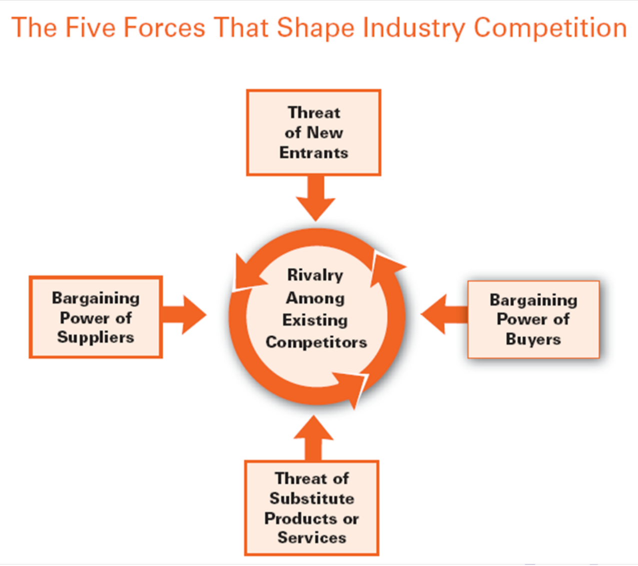
Overview

- 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



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 Retailiation

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.