Porter five forces assist an organisation in their strategic planning

Business, Strategy

How does Porters Five Forces Model assist an organisation in their strategic planning? Before understanding “ how” we must know “ what” Porters Five Forces model really is (Michael E. Porter, 2008). Company strive to secure a competitive advantage over their rivals, I mean who doesn’t want to be the best? Although the intensity of rivalry varies within each industry and these differences can be important in the development of strategy, but rather the five forces (Porter, 2008) being a strategy of any sort, it acts a framework in securing a strategy.

The only time where strategy is irrelevant, would be when you have no competitors where ultimately theenvironmentis a monopoly, or when you have a ton ofmoneyto throw around and waste. But having said that, it is not likely at all. Without framework, strategy will inevitably collapse, as they both come hand in hand. Thus a chain arises as the five forces (Porter, 2008) acts as a framework in assisting an organisation in their strategic planning, where strategic planning leads to a competitive advantage over their competitors which then leads to ultimate success of the company.

Before proceeding to the question at hand on how Porters Five Forces can assist an organisation in their strategic planning, first we have to know two things, what are the Five Forces that Porter (2008) proposed, and ultimately what strategy really means? To ease this journey, let’s start with the Five Forces (Porter, 2008).

Before any company enters a certain market, one must first analyse the competitive nature of the market, and this is exactly what the Five Forces (2008) aids to do, to provide a framework to determine the intensity of competition within an industry where three of the five competitive forces comes from an external sources, and the remainder coming from an internal sources. These external sources includes: Threat of potential entrants, threat of potential substitutes and rivalry of existing firms in the industry.

Now these sources are external due to the fact that it is simply impossible to temper with. But what we can control, are the two internal sources: the bargaining power of suppliers, and the bargaining power of buyers. Being aware of the five forces can aid firms into identifying existence and the importance of each of the five forces, as well as the roles that each force plays into the success of the firms. The threat of potential entrants: Although it is possible for any company to enter and exit a market of their choice, each market has their own unique barriers to go in and out of.

Therefore the essence of this force deals with the level of difficulty that a company can enter into an industry which will ultimately impact competition within the industry. Whenever a new company enters an industry, the competitive climate changes; it provides more alternatives to consumers, therefore reducing its attractiveness and the competition within the industry increases as each company is trying to come out on top. As each industry have their own unique characteristics it allows them to build a barrier from other industries protecting them from profitability while restraining additional rivals from entering the market.

These restraints and characteristics that industries create are referred to as barriers of entry. Barriers of entry are a characteristic acquired uniquely to each industry. It attempts to reduce the rate of entry of new companies which maintains the level of profitability for all current industry competitors, where if new companies enters the industry, the profit is shared amongst the original and the newly developed companies in the industry, ultimately decreasing overall profits of each company, which isn't ideal.

Conversely when profitability of an industry is high, companies will attempt to come into the industry to get a piece of the action, which then will eventually result in reducing profits due to the fact that it is divided up into more quarters. Where there's an entry, there's an exit, barriers to exit limits the ability of a firm to leave the market, meanwhile rivalries can worsen. So when barriers for entry and exits are high, it means that companies have a higher potential to make more profit and the opposite occurs when barriers are low.

The threat of substitutes: where it refers to substitute product as those that are available in other industry which can also fulfil the need and want of the consumers. It can affect competition in an industry by placing an invisible ceiling on prices which companies within the industry can charge, due to the fact that if the cost of substitute is low then the consumers will tend to purchase substitutes, therefore limiting the prices that a company can place on certain items to gain maximum profit. For example, lemonade can be substituted for a soft drink.

Generally, competitive pressures arising from substitute products increase as the relative price of substitute products declines and as consumer's switching costs decrease. The bargaining power of buyers is affected by the concentration and number of consumers, when buyer power is strong, they gain the power to choose between producers and ultimately equip themselves with bargaining power which then the producers will have to conform to in order to produce profit, under these conditions the buyer has the most influence in determining the price of products.

Also when buyers have strong bargaining power in the exchange relationship, competition can be affected in several ways. Powerful buyers can bargain for lower prices, better product distribution, higher-quality products, as well as other factors that can create greater competition among companies. To minimise the power of buyers, companies can develop offers in which strong buyers cannot refuse, also, companies can choose to select buyers with less bargaining power.

Similarly, the bargaining power of suppliers affects the intensity of competition in an industry, for a production industry that produces goods, raw materials are needed which creates a buyer and supplier relationship between the industry and companies which produces the raw materials. Suppliers may be able to determine prices especially when there are a large number of suppliers, limited substitute raw materials, or increased switching costs. The bargaining power of suppliers is important to industry competition because suppliers can also affect the quality of exchange relationships.

Competition may become more intense as powerful suppliers raise prices, reduce services, or reduce the quality of goods or services. In order to minimise the power of suppliers, industry tend to build win-win relationships with suppliers where both parties benefits from it or arrange to use multiple suppliers so if one supplier chooses to increase their prices, the company doesn’t get affected as much. Competition is also affected by the rivalry among existing firms, which is usually considered as the most powerful of the five competitive forces.

In most industries, business organizations are mutually dependent, industries that are concentrated versus fragmented; often display the highest level of rivalry. A competitive move by one company in pursuing an advantage over its rivals can be expected to have a noticeable effect on its competitors, and thus, may cause retaliation of other companies, for example, lowering prices, enhancing quality, adding features, providing services, extending warranties, and increasing advertising, placing themselves in a competitive advantage over the competitors.

The nature of competition is often affected by a variety of factors, such as the size and number of competitors, demand changes for the industry's products, the specificity of assets within the industry, the presence of strong exit barriers, and the variety of competitors. These conditions will lead to a more challenging industry where companies compete in, leading to price wars, advertising battles, and the addition of new products. So after going through the five forces, let’s take a look at what strategic planning really means.

If we are going to have a good strategy, we must separate strategy fromgoalsand objectives and other issues that managers often think about. Now most management practitioners make the mistake in defining strategy, a strategy is what unique position that we will be able to achieve, what our advantage is going to be at the end of the day as we take these steps accumulatively over time, how we're going to be unique? How we're going to have an advantage? How we're going to sustain the advantage over time? Schermerhorn, Davidson, Poole, Simon, Woods, Chau, 2011). The steps we take aren't a strategy, but somehow numerous companies make the mistake of fixating themselves on a particular action that an organisation want to approach, which then inevitably becomes their strategy but that usually leads to the downfall of the company simply because they do not know why they're doing it and when they should stop doing it. As we all know, every industry is different, therefore, there is no universal strategy that can apply to any business.

But before proceeding, a company must understand their position and the industry that they are in and their circumstances in order to find a way of obtaining a competitive advantage over the competitors, where indefinitely delivering a unique value to the consumers which rivals cannot. As the five forces (Porter, 2001) suggests that being at a competitive advantage is the idealistic way of being on top, due to the fact that every industry has their own set of economics, the five forces (Porter, 2001) without a doubt acts as a framework to extract any necessary information needed to develop strategy to gain competitive advantage.

The Five forces (Porter, 2001) help you home in on what is really causing profitability, or in fact what is causing the trends of the significance and change of the industry. This powerful framework can prevent an organisation from getting tricked or trapped into the latest trends like the technological sensation, and really allowing organisations to focus solely on the underlying fundamentals. This can be applied to any industry whether if its production or a service, high tech or low tech, emerging or developed industries (Porter, 2001).

With the framework at hand, it acts as a guide or even a tick off criteria sheet into strategic planning, how should we begin? The strategy formulating process will be pretty straight forward from here after deeply understanding the five forces which Porter (2001) proposed. The first step should be the analysis of the industry that a company is trying to get into, looking at the environment to tick off all of the 5 boxes one by one, evaluating what the industry looks like, how it’s been changing over time, and what are the drivers of competition (Schermerhorn et al, 2011).

After a careful analyse the company is then required to under the dynamics as to where the industry is going, how the buyers and substitute’s entry level are evolving, and lastly how to position the company to gain a good profit. These are all extracted from the framework proposed by Porter (2001), although competition is sometimes looked at too narrowly, with careful analysis of the five forces (Porter, 2001) will ultimately position the company in a competitive advantage.

Where a competitive advantage allows an organisation to deal with the market and environmental forces much better than its competitors (Ramon, 2012), to achieve this goal, the company needs to be at its best and better than the competitors who are trying to achieve the same goal in the same industry. Rather than a goal, competitive advantage is a position that a company wants to be in, a goal is to make the competitive advantage sustainable in spite of all the mockery of rivals, although achieving and sustaining it is a challenging task, but it will set concrete roots for the company in years to come.

The implementation of strategic planning tools serves a variety of purposes in companies, including the clear definition of an organization's purpose and mission, and the establishment of a standard base from which progress can be measured and future actions can be planned. I-O psychologist Ramon E, Henson (2012) and Robert E, Ployhart (2012) although having disagreements in some parts of their papers, they ultimately come forward in reinforcing the importance of competitive advantage suggesting that I-O and strategy has been “ joined at hips for years” (Ramon, 2012), also suggesting hat I-Opsychologyshould stray from the focus of individuals and start focusing more on the company as a whole as they have “ much to offer” in the understanding of competitive advantage (Ployhart, 2012). Furthermore, the strategic planning tools should communicate those goals and objectives to the organisation as a whole rather than just the ones involved in the strategic planning process (O’Shannassy, 2003) to achieve a more efficient work flow. Throughout the centuries, countless strategic approaches has been formed and used and recycled, so why use Porter’s Five Forces (2008)?

For example, strategy as simple rules Kathleen M. Eisenhardt, ; Donald N. Sull, (2001). It illustrates the success story of Yahoo! , along with other successful companies coming from an unattractive market. “ So how they did succeed? More generally, what are the sources of competitive advantage in high-velocity markets? What does strategy mean in the new economy? ”

(Eisenhardt et al, 2001, p. 108). The key is none-other than strategy as simple rules, it targets market confusion and rides the magic carpet to see where or what it will journey into.

Although it is indeed called “ simple rules”, a rule still applies to it, as one Internet executive explained: “ I have a thousand opportunities a day; strategy is deciding which 50 to do. ” (Eisenhardt et al, 2001, p. 108). As it summarises and illustrates that simple rules is all about taking risks, its essence is to capture unanticipated opportunities for ultimate success. Although for companies like Yahoo! has gained huge success, simple rules (2001) cannot apply to any industry as the authors suggests (Eisenhardt et al, 2001).

If the opportunity presents itself, for anyone to use simple rules (2001) as a stepping stone to success, without a doubt, one should take the opportunity, but an opportunity does not just come without any background knowledge of a particular industry, and this is where Porter’s Five Forces (2008) comes into play, as it provides a framework for careful analysis of the industry, by analysing the industry will allow you to grab hold of the opportunities that might come about. Despite the fact that there are numerous of strategies to obtain competitive advantage, Porters Five Forces (2008) acts as a basis of all these trategies, as it is a tick-off criteria sheet which allows a company to understand their position before even implementing any sort of action. It is important as companies strives for ultimate profitability, thus the importance of a company securing a competitive advantage over their competitors is key, as even I-O psychologists supports the important of competitive advantage and that it should be a “ department on its own” (Ployhart, 2012). How to implement strategy and sustaining it is another question. Although Yahoo! nd some other companies has succeeded without the five forces (Porter, 2008), it is a dangerous and risky step, and for those who doesn’t have the resource to throw around, Porters Five Forces (2008) will not only act as a friend but mentor to the journey of success. Reference John R. Schermerhorn, Paul Davidson, David Poole, Alan Simon, Peter woods ; So Ling Chau (2011). Management 4th Asia-Pacific Edition. Queensland, Australia: John Wiley ; Sons Australia, Ltd. Kathleen M. Eisenhardt, ; Donald N. Sull, (2001). Strategy as Simple Rules. HarvardBusiness Review, 79(1), 106-116.

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